

TITLE V. — PRESCRIPTION

Chapter 1

GENERAL PROVISIONS

Article 1106. By prescription, one acquires ownership and other real rights through the lapse of time in the manner and under the conditions laid down by law.

In the same way, rights and actions are lost by prescription.

COMMENT:

(1) Definition of Prescription

Prescription is a mode of acquiring (or losing) ownership and other real rights thru the lapse of time in the manner and under the conditions laid down by law, namely, that the possession should be:

- (a) in the concept of an owner
- (b) public
- (c) peaceful
- (d) uninterrupted. (*Arts. 1106, 1118, Civil Code*).
- (e) adverse. In order that a possession may really be adverse, the claimant must clearly, definitely, and unequivocally notify the owner of his (the claimant's) intention to avert an exclusive ownership in himself. (*Clendenin v. Clendenin, 181 N.C. 465 and Director of Lands v. Abiertas, CA-GR 91-R, Mar. 13, 1947, 44 O.G. 923*).

(2) Proof Needed

Because prescription is an *extraordinary* mode of acquiring ownership, all the essential ingredients, particularly the *period* of time, must be shown clearly. (*Boyo v. Makabenta, CA-GR 7941-R, Nov. 24, 1952*).

(3) Reasons or Bases for Prescription

- (a) *Economic necessity* (otherwise, property rights would remain unstable).

**Director of Lands, et al. v. Funtillar, et al.
GR 68533, May 23, 1986**

FACTS: Where the land sought to be registered was declared alienable and disposable 33 years ago, and is no longer a forest land, and the same has been possessed and cultivated by the applicants and their predecessors for at least three generations.

HELD: The attempts of humble people to have disposable lands they have been tilling for generations titled in their names should not only be viewed with an understanding attitude but should, as a matter of policy, be encouraged.

- (b) *Freedom from judicial harassment* (occasioned by claims without basis).
- (c) *Convenience in procedural matters* (in certain instances, juridical proof is dispensed with).
- (d) *Presumed abandonment or waiver* (in view of the owner's indifference or inaction).

(4) Classification of Prescription

- (a) as to whether rights are acquired or lost:
 - 1) *acquisitive prescription* (prescription of ownership and other real rights).
 - a) ordinary prescription
 - b) extraordinary prescription

- 2) *extinctive prescription* (“liberatory prescription;” prescription of actions); (“Statute of Limitations”).
- (b) as to the object or subject matter:
 - 1) prescription of property
 - a) prescription of *real* property
 - b) prescription of *personal* rights
 - 2) prescription of rights

(5) Laches

Laches (or “estoppel by laches”) is unreasonable delay in the bringing of a cause of action before the courts of justice. Thus, if an action prescribes say in ten (10) years, it should be brought to court as soon as possible, without waiting for 8 or 9 years, unless the delay can be justifiably explained (as when there is a search for evidence). Note therefore, that while an action has not yet prescribed, it may no longer be brought to court because of laches.

As defined by the Supreme Court, “laches is failure or neglect, for an unreasonable and unexplained length of time, to do that which, by exercising due diligence, could or should have been done earlier; it is negligence or omission to assert a right within a reasonable time, warranting a presumption that the party entitled thereto either has abandoned it or declined to assert it. However, courts will not be bound by strictures of the statute of limitations or laches when manifest wrong or injuries would result thereby.” (*Cristobal v. Melchor*, 78 SCRA 175).

Arradaza, et al. v. CA & Larrazabal GR 50422, Feb. 8, 1989

The principle of laches is a creation of equity. It is applied, not really to penalize neglect or sleeping upon one’s right, but rather to avoid recognizing a right when to do so would result in a clearly inequitable situation.

(6) Rationale for Laches

If a person fails to act as soon as possible in vindication of an alleged right, it is possible that the right does not really exist.

(7) 'Prescription' Distinguished from 'Laches'**Mapa III v. Guanzon
77 SCRA 387**

While prescription is concerned with the FACT of delay, laches deals with the EFFECT of *unreasonable* delay.

**David v. Bandin
GR 48322, Apr. 8, 1987**

FACTS: A and B, husband and wife, died intestate, leaving two children, X and Y. X had been administering the property until her death in Feb. 15, 1955. Plaintiffs, the children of Y, were given their shares of the fruits of the property, though irregular and at times little, depending on the amount of the harvest. On April 23, 1963, plaintiffs, the children of Y, sent a letter of demand to the heirs of X for partition, and on June 14, 1963, or within a period of approximately 8 years from X's death, filed their complaint against X's heirs.

HELD: Plaintiffs cannot be held guilty of laches, nor is their claim barred by prescription. Plaintiffs were not guilty of negligence nor did they sleep on their rights.

Prescription generally does not run in favor of a co-heir or co-owner as long as he expressly or impliedly recognizes the co-ownership. While implied or constructive trust prescribes in 10 years, the rule does not apply where a fiduciary relation exists and the trustee recognizes the trust.

**Gallardo v. Intermediate Appellate Court
GR 67742, Oct. 29, 1987**

In determining whether a delay in seeking to enforce a right constitutes laches, the existence of a confidential relationship between the parties is an important circumstance for consideration. A delay under such circumstance is not as strictly regarded as where the parties are strangers to each other. The doctrine of laches is not strictly applied between near relatives, and the fact that parties are connected by ties of blood or marriage tends to excuse an otherwise unreasonable delay.

**Narciso Buenaventura & Maria Buenaventura
v. CA & Manotok Realty, Inc.
GR 50837, Dec. 28, 1992**

The defense of laches applies independently of prescription. Laches is different from the statute of limitations. Prescription is concerned with the *fact* of delay, whereas laches is concerned with the *effect* of delay. Prescription is a matter of time; laches is principally a question of inequity of permitting a claim to be enforced, this inequity being founded on the same change in the condition of the property or the relation of the parties. Prescription is statutory; laches is not. Laches applies in equity, whereas prescription applies at law. Prescription is based on fixed time; laches is not.

(8) Constitutional Provision

The right of the State to recover properties unlawfully acquired by public officials or employees, from them or from their nominees or transferees, shall not be barred by prescription, laches, or estoppel. (*Sec. 15, Art. XI, The 1987 Philippine Constitution*).

(9) Cases

**Republic v. Animas
56 SCRA 871**

Prescription does not run against the State, especially because the recovery of unlawfully acquired properties has become a State policy.

**Aldovino v. Alunan III
49 SCAD 340
(1994)**

Prescription must yield to the higher interest of justice.

**Francisco v. CA
122 SCRA 538**

Philippine jurisprudence shows that the filing of the complaint, even if merely for purposes of preliminary examination

or investigation, suspends and interrupts the running of the prescriptive period.

(10) Prescriptive Period on Registered Land covered by Torrens System

**Quirino Mateo & Matias v.
Dorotea Diaz, et al.
GR 137305, Jan. 17, 2002**

FACTS: The land involved is registered under the Torrens system in the name of petitioners' father Claro Mateo. There is no question raised with respect to the validity of the title. Immediately after petitioners discovered the existence of OCT 206 in 1977 or 1978, they took steps to assert their rights thereto. They divided the land between the two of them in an extrajudicial partition. Then petitioners filed the case below to recover ownership and possession as the only surviving children of original owners, the late Claro Mateo.

The Regional Trial Court (RTC), Bulacan, at Malolos, ruled that prescription and laches are applicable against petitioners, that real actions over an immovable prescribe after 30 years, that ownership can be acquired thru possession in good faith and with just title for a period of 10 years, and that ownership may be acquired thru uninterrupted adverse possession for 30 years without need of just title or of good faith. The Court of Appeals (CA) affirmed that of the trial court, thus, this *petition for review on certiorari*.

ISSUE: Whether or not the equitable doctrine of laches may override a provision of the Land Registration Act on imprescriptibility of title to registered land. Otherwise put, the issue raised is whether prescription and the equitable *principle of laches* are applicable in derogation of the title of the registered owner.

HELD: A party who had filed immediately a case as soon as he discovered that the land in question was covered by a transfer certificate in the name of another person is not guilty of laches. (*St. Peter Memorial Park, Inc. v. Cleofas*, 92 SCRA 389 [1979]). An action to recover possession of a registered land never prescribe in view of the provision of Sec. 44 of Act 496 (now

Sec. 47 of PD 1529) to the effect that no title to registered land in derogation to that of a registered owner shall be acquired by prescription or adverse possession. (*J.M. Tuason & Co. v. Aquirre*, 7 SCRA 109 [1963]).

In fact, there is a host of jurisprudence that hold that prescription and laches could not apply to registered land covered by the Torrens system. (*Bishop v. CA*, 208 SCRA 636 [1992] and *St. Peter Memorial Park, Inc. v. Cleofas*, *supra*). With more reason are these principles applicable to laches, which is an equitable principle. Laches may not prevail against a specific provision of law, since *equity*, which has been defined as “justice outside legality” is applied in the obscene of and not against statutory law or rules of procedure. (*Causapin v. CA*, 233 SCRA 615 [1994]).

Upon the other hand, the heirs of the registered owner are not estopped from claiming their father’s property, since they merely stepped into the shoes of the previous owners. Prescription is unavailing not only against the registered owner, but also against his hereditary successors because the latter merely step into the shoes of the decedent by operation of law and are merely the continuation of the personality of their predecessor-in-interest. (*Teofila de Guinoo v. CA* [97 Phil. 235] and *Gil Atun v. Eusebio Nuñez* [97 Phil. 762]).

The CA erred in ordering the Register of Deeds to cancel OCT 206 of Claro Mateo and issue new titles to those who are occupying the subject land. This violates the indefeasibility of a Torrens title. The title of Claro Mateo could be cancelled only if there is competent proof that he had transferred his rights over the parcel of land to another party, otherwise title would pass to his heirs only by testate or intestate succession.

The fallo: The Supreme Court thereupon reverses the CA’s decision. In lieu thereof, the Court remands the case to the trial court for determination of the heirs of Claro Mateo in a proper proceeding.

Far East Bank & Trust Co. v. Estrella O. Querimit
GR 148582, Jan. 16, 2002

FACTS: Respondent deposited her savings with petitioner-bank. She did not withdraw her deposit even after maturity date

of the certificates of deposit (CDs) precisely because she wanted to set it aside for her retirement, relying on the bank's assurance, as reflected on the face of the instruments themselves, that interest would "accrue" or accumulate annually even after their maturity.

Petitioner-bank failed to prove that it had already paid respondent, bearer and lawful holder of subject CDs, *i.e.*, petitioner failed to prove that the CDs had been paid out of its funds, since evidence by respondent stands un rebutted that subject CDs until now remain unindorsed, undelivered, and unwithdrawn by her.

ISSUE: Would it be unjust to allow the *doctrine of laches* to defeat the right of respondent to recover her savings which she deposited with the petitioner?

HELD: Yes, it would be unjust not to allow respondent to recover her savings which she deposited with petitioner-bank. For one, Petitioner failed to exercise that degree of diligence required by the nature of its business. (*Art. 1173*). Because the business of banks is impressed with public interest, the degree of diligence required of banks is more than that of a good father of the family or of an ordinary business firm.

The fiduciary nature of their relationship with their depositors requires banks to treat accounts of their clients with the highest degree of care. (*Canlas v. CA, 326 SCRA 415 [2000]*). A bank is under obligation to treat accounts of its depositors with meticulous care whether such accounts consist only of a few hundred pesos or of millions of pesos. Responsibility arising from negligence in the performance of every kind of obligation is demandable. (*Prudential Bank v. CA, 328 SCRA 264 [2000]*). Petitioner failed to prove payment of the subject CDs issued to respondent and, therefore, remains liable for the value of the dollar deposits indicated thereon with accrued interest.

A certificate of deposit is defined as a written acknowledgment by a bank or banker of the receipt of a sum of money on deposit which the bank or banker promises to pay to the depositor, to the order of the depositor, or to some other person or his order, whereby the relation of debtor and creditor between the bank and the depositor is created. Principles governing other

types of bank deposits are applicable to CDs (*10 AM Juri 2d Sec. 455*), as are the rules governing promissory notes when they contain an unconditional promise to pay a sum certain of money absolutely. (*Ibid.*, *Sec. 457*).

The principle that payment, in order to discharge a debt, must be made to someone authorized to receive it is applicable to the payment of CDs. Thus, a bank will be protected in making payment to the holder a certificate indorsed by the payee, unless it has notice of the invalidity of the indorsement or the holder's want of title. (*10 Am Jur 2d Sec. 461*). A bank acts at its peril when it pays deposits evidenced by a CD, without its production and surrender after proper indorsement. (*Clark v. Young, 21 So. 2d 331 [1994]*).

The equitable *principle of laches* is not sufficient to defeat the rights of respondent over the subject CDs. *Laches* is the failure or neglect, for an unreasonable length of time, to do that which, by exercising due diligence, could or should have been done earlier. It is negligence or omission to assert a right within a reasonable time, warranting a presumption that the party entitled to assert it either has abandoned it or declined to assert it. (*Felizardo v. Fernandez, GR 137509, Aug. 15, 2001*).

There is no absolute rule as to what constitutes laches or staleness of demand; each case is to be determined according to its particular circumstances. The question of laches is addressed to the sound discretion of the court and, being an equitable doctrine, its application is controlled by equitable considerations. It cannot be used to defeat justice or perpetrate fraud and injustice. Courts will not be guided or bound strictly by the Statute of Limitations or the doctrine of laches when to do so manifest wrong or injustice would result. (*Rosales v. CA, GR 137566, Feb. 28, 2001*).

Respondent is entitled to moral damages because of the mental anguish and humiliation she suffered as a result of the wrongly refusal of petitioner to pay her even after she had delivered the CDs. (*Arts. 2217 and 2219*). In addition, petitioner should pay respondent exemplary damages which the trial court imposed by way of example or correction for the public good (*Art. 2229*). Finally, respondent is entitled to attorney's fees since petitioner's act or omission compelled her to incur expenses to

protect her interest making such award just and equitable. (*Art. 2208*).

Development Bank of the Phils. v. CA & Carlos Cajes
GR 129471, Apr. 28, 2000

FACTS: Petitioner filed an ejectment suit against private respondent, claiming ownership of a parcel of land covered by a TCT, which included the 19.4 hectares being occupied by the latter. The trial court declared petitioner to be the owner of the land, but the Court of Appeals (CA) reversed the trial court. On appeal, petitioner claimed that its predecessor-in-interest had become the owner of the land by virtue of the decree of registration in his name. The Supreme Court affirmed the CA.

HELD: Taking into consideration the possession of his predecessor-in-interest, private respondent had been in uninterrupted adverse possession of the land for more than 30 years prior to the decree of registration issued in favor of petitioner's predecessor-in-interest. Such possession ripened into ownership of the land thru *acquisitive prescription*, a mode of acquiring ownership and other real rights over immovable property. A decree of registration cut off or extinguished a right acquired by a person only when such right refers to a lien or encumbrance on the land which was not annotated on the certificate of title issued thereon, but not to the right of ownership thereof. Registration of land does not create a title nor vest one. Accordingly, the 19.4 hectares of land being occupied by private respondent must be reconveyed in his favor.

(11) Presumptive Period re Ill-Gotten Wealth or 'Behest' Loans

Presidential Ad Hoc Fact-Finding Committee
on Behest Loans v. Aniano A. Desierto
(Recovery of Ill-Gotten Wealth)
GR 130340, Oct. 25, 1999
114 SCAD 707

Behest loans, which are part of the ill-gotten wealth which former President Ferdinand E. Marcos and his cronies accumulated and which the Government thru the Presidential

Commission on Good Government (PCGG) seeks to recover, have a *prescriptive period* to be counted from the discovery of the crimes charged, and not from the date of their commission. If the commission of the crime is known, the prescriptive period shall commence to run on the day it was committed.

The prosecution of offenses arising from, relating or incident to, or involving ill-gotten wealth contemplated in Sec. 15, Art. XI of the Philippine Constitution of 1987 may be barred by prescription. Said provision applies only in civil actions for recovery of ill-gotten wealth, and not to criminal cases.

Art. 1107. Persons who are capable of acquiring property or rights by the other legal modes may acquire the same by means of prescription.

Minors and other incapacitated persons may acquire property or rights by prescription, either personally or through their parents, guardians or legal representatives.

COMMENT:

(1) Who May Acquire Property or Rights by Prescription

- (a) those who can make use of the other modes of acquiring ownership.
- (b) even minors and other incapacitated persons (like the insane).

(2) Reason for Par. 1 (Those Capable of Acquiring Property or Rights Thru the Other Modes)

Since prescription is also a mode of acquiring ownership, it follows that if a person is capable of becoming an owner by the other legal modes, he should also be capable of acquiring the same property by prescription. Thus, if a person can become an owner by donation, he can also become an owner by prescription.

(3) Query (Re Donation by Paramour)

A husband cannot validly receive a donation from a paramour. Now then, can he acquire by prescription the property donated to him by the paramour?

ANS.: Yes, but only by *extraordinary* prescription (not *ordinary* prescription) since he would be lacking the element of “just title.” There would be no “just title” because under the law, they are incapacitated to donate to each other. (See Art. 739, *Civil Code*). Note that even if a donation is VOID, it may constitute the legal basis for adverse possession. (See *Tagalgal v. Luega, CA-GR 19651-R, Feb. 19, 1959*).

(4) Reason Why Minors May Acquire Personally

This is because only juridical capacity is required for possession, not capacity to act. Thus, even discernment of intent to possess is not required for such personal acquisition. This is so because the law makes no distinction.

Art. 1108. Prescription, both acquisitive and extinctive, runs against:

(1) Minors and other incapacitated persons who have parents, guardians or other legal representatives;

(2) Absentees who have administrators, either appointed by them before their disappearance, or appointed by the courts;

(3) Persons living abroad, who have managers or administrators;

(4) Juridical persons, except the State and its subdivisions.

Persons who are disqualified from administering their property have a right to claim damages from their legal representatives whose negligence has been the cause of prescription.

COMMENT:

(1) Persons Against Whom Prescription May Run

- (a) The Article enumerates four such groups.
- (b) *Reason for Pars. 1, 2, and 3:*

These people are supposed to be protected by those in charge. If they are not properly protected thru the lat-

ter's negligence, a claim for damages against the latter can prosper.

(2) Query (Re Minors Without Parents, etc.)

Suppose the minors or the insane persons have no parents or legal representatives, does prescription run against them?

ANS.: While the Article seemingly implies that in such a case, prescription should not run against them, it is believed that Secs. 42, 45, and 46 of Act No. 190 (the Code of Civil Procedure) can apply to them, since implied repeals are not looked upon with favor. Thus, prescription can still run against minors, the insane, and those in jail, *except* that these people may still bring the action within a number of years after their disability has been removed:

- (a) 3 years — in case of recovery of land
- (b) 2 years — in other civil actions

These saving clauses are in line with some saving clauses provided for minors and the incapacitated under the New Civil Code. (See, for example, Art. 285 with respect to the right of a natural child to compel recognition *after* the parent's death, if the parent dies while the child was still a minor).

If the minor has a guardian, there is NO DOUBT that prescription runs against him even during minority. (*See Wenzel, et al. v. Surigao Consolidated Mining Co., L-10843, May 31, 1960*).

(3) State and Its Subdivisions

No prescription can run against them, except with reference to patrimonial property. (*See Art. 1113, Civil Code*).

Art. 1109. Prescription does not run between husband and wife, even though there be a separation of property agreed upon in the marriage settlements or by judicial decree.

Neither does prescription run between parents and children, during the minority or insanity of the latter, and between guardian and ward during the continuance of the guardianship.

COMMENT:**(1) No Prescription Between Husband and Wife**

- (a) *Reason for the law* — The close relationship between them, engendered by affection or influence, may prevent one from suing the other. Hence, the general rule is — NO PRESCRIPTION.

(NOTE: The Article was applied in *Toriba Fontanilla Pacio, et al. v. Manuela Pacio Billon, et al.*, L-15088, Jan. 31, 1961).

- (b) Note that there is no prescription even if there has been a “separation of property,” for the same reluctance to sue each other may still exist.
- (c) *Query* —

Suppose the “separation of property” is the consequence of legal separation, does prescription run?

ANS.: It is believed that prescription will also *not* run, for the law does not distinguish. After all, here, the “separation of property” would be “by judicial decree.”

- (d) *Exceptions* — when prescription is specifically provided for by law, such as:
- 1) the prescriptive period for legal separation suits (*Art. 120, Civil Code*);
 - 2) alienations made by the husband, without the wife’s consent. (*Art. 173, Civil Code*).

(2) Between Parents and Children

- (a) No prescription shall run between them during the MINORITY or INSANITY of the latter. A *sensu contrario* prescription runs if the legal disability does not exist anymore.
- (b) As a general rule, even if the child is neither insane nor incapacitated, an adverse possession *cannot* be predicated on the possession of the parent as against the child, or in the possession of the child as against its parent. Thus, where a father became insane, and one of his sons managed the

farm during the rest of his father's lifetime and remained in possession of it for the statutory period, it was held that these facts alone did *not* warrant the presumption of a conveyance to the son by the father or of a release to him by the other heirs subsequent to their father's death. (*1 Am. Jur. 807 and Director of Lands v. Abiertas, 44 O.G. 923*).

(3) Between Guardian and Ward

No prescription runs between them during the continuance of the guardianship. This is so even if the guardian expressly repudiates the guardianship (without court approval); otherwise, the trust relationship would be rendered nugatory.

Art. 1110. Prescription, acquisitive and extinctive, runs in favor of, or against a married woman.

COMMENT:

Prescription in the Case of a Married Woman

This Article refers to a married woman and a *stranger*.

Art. 1111. Prescription obtained by a co-proprietor or a co-owner shall benefit the others.

COMMENT:

(1) Prescription Obtained by Co-Proprietor or Co-Owner

Reason:

In a sense, a co-owner or co-proprietor acts for the interest of the whole co-ownership. Similarly, an action for ejectment may be brought by just one of the co-owners. (*See Art. 487, Civil Code*).

[*NOTE*, however, that as between or among co-owners, there can be prescription when there is a definite repudiation of the co-ownership, made known to the other co-owners. (*Laguna v. Levantino, 71 Phil. 566*).]

(2) Limitation

The prescription obtained by a co-owner must have reference to the property held in common, naturally; otherwise the Article does not apply.

Art. 1112. Persons with capacity to alienate property may renounce prescription already obtained, but not the right to prescribe in the future.

Prescription is deemed to have been tacitly renounced when the renunciation results from acts which imply the abandonment of the right acquired.

COMMENT:**(1) Requisites for Renunciation of Property Acquired by Prescription**

- (a) Renouncer must have capacity to alienate property (because renunciation is an exercise to the *jus disponendi*).
- (b) The property acquired must have already been obtained (hence, the right to prescription in the *future cannot* be renounced, since manifestly, this would be contrary to public policy).
- (c) The renouncing must be made by the owner of the right (not by a mere administrator or guardian, for he does not own the property).
- (d) The renouncing must not prejudice the rights of others, such as creditors. (*Arts. 6, 1114, Civil Code*).

(2) Form

- (a) may be express or implied (tacit)
- (b) requires no consent on the part of the person to be benefited
- (c) requires no solemnities or formalities

(3) Implied or Tacit Renunciation

There is tacit renunciation when there is an action which implies the *abandonment* of the right acquired.

Example:

Sonia formerly owed Esperanza but the debt has already prescribed.

- (a) If Sonia, *knowing* that the debt has prescribed, nevertheless still acknowledges the existence of the debt and promises to pay for it, there is an *implied renunciation* of the prescription. She still has a *civil* obligation.
- (b) If Sonia, *knowing* that the debt has prescribed, nevertheless voluntarily pays the debt, she cannot recover what she had paid. This would be a *natural* obligation.
- (c) If Sonia, *not knowing* that the debt has prescribed pays it, there is *no* renunciation of the prescription; and she can still recover on the basis of *solutio indebiti*.

ILLUSTRATIVE CASE: If a taxpayer, complaining repeatedly against a tax assessment, makes several requests for a reinvestigation thereof, he may be said to have WAIVED the defense of prescription. (*Yutivo & Sons Hardware Co. v. Ct. of Tax Appeals & Collector of Int. Rev.*, L-13203, Jan. 28, 1961).

Art. 1113. All things which are within the commerce of men are susceptible of prescription, unless otherwise provided. Property of the State or any of its subdivisions not patrimonial in character shall not be the object of prescription.

COMMENT:**(1) Things That May Be Acquired by Prescription**

Generally — all things within the commerce of man.

(2) Patrimonial Property

- (a) By implication under this Article, *patrimonial* property of the State or any of its subdivisions may be acquired by prescription.
- (b) While it may be claimed that a direct and clear provision (*Art. 1108, Civil Code* — which says that prescription does not run against the State or any of its subdivisions) prevails

over an implication (*Art. 1113, Civil Code*), still when we consider the intent of Congress in inserting the phrase “not patrimonial in character” in the original draft submitted by the Code Commission, it is clear that patrimonial property may indeed be the subject of prescription. This is so because patrimonial properties are really in the same category as private properties.

(3) No Prescription With Respect to Public Property

Public property, however, cannot be the subject of prescription. This rule applies even to *privately owned unregistered lands* which, unless the contrary is shown, are *presumed to be public lands*, under the principle that “all lands belong to the Crown unless they had been granted by the King (State) or in his name, or by the Kings who preceded him.” (*Valenton v. Murciano*, 3 *Phil.* 53).

However, the rule just stated cannot be altogether inflexible, as witnessed, for example, by the presence of *Rep. Act 1942* (approved June 22, 1957), amending Sec. 48(b) of the Public Land Act (*Com. Act 141*). Thus, as amended by RA 1952, Sec. 48 of CA 141 now reads as follows:

“Section 48. The following described citizens of the Philippines occupying *lands of the public domain* or claiming to own any such land or an interest therein, but whose titles have not been perfected or completed, may apply to the Court of First Instance of the province where the land is located for confirmation of their claims and the issuance of a certificate of title therefor, under the Land Registration Act, to wit:

x x x

“b) Those who by themselves or through their predecessors in interest have been in open, continuous, exclusive and notorious possession and occupation of agricultural lands of the public domain, under a *bona fide* claim of acquisition of ownership, for at least *thirty years* immediately preceding the filing of the application for confirmation of the title except when prevented by war or *force majeure*. These shall be conclusively presumed to have performed all the conditions essential to a Government grant, and shall be entitled to a certificate of title

under the provisions of this chapter (the chapter deals with judicial confirmation of imperfect or incomplete titles).”

(NOTE: However, under *RA 107*, the deadline of the application was only up to Dec. 31, 1957.)

(4) Some Doctrines

- (a) A fishpond constructed in the Bambang River can be ordered removed by the government, regardless of the number of years that have elapsed since the construction of said fishpond, inasmuch as a river, or a portion thereof, is property of public dominion, and cannot therefore be acquired by acquisitive prescription. (*Meneses v. Commonwealth*, 69 Phil. 647).
- (b) Similarly, a tract of land, formerly low and swampy, but gradually raised by the action of the sea, is not susceptible of prescription, and may therefore be recovered by the government despite the construction thereon of warehouses and a wharf. The land is part of the public domain. (*Insular Government v. Aldecoa and Co.*, 19 Phil. 505).
- (c) A plaza intended for public use is likewise not subject to prescription. (*Harty v. Mun. of Victoria*, 13 Phil. 152).

(5) Things or Properties That Cannot Be Acquired by Prescription

- (a) those protected by a Torrens Title. (*Sec. 46, Act No. 496*) (*Francisco v. Cruz*, 43 O.G. 5103).
- (b) movables acquired thru a crime. (*Art. 1133, Civil Code*).
- (c) those outside the commerce of men. (*Art. 1113, Civil Code*).
- (d) properties of spouses, parents and children, wards and guardians, under the restrictions imposed by law. (*Art. 1109, Civil Code*).

Art. 1114. Creditors and all other persons interested in making the prescription effective may avail themselves thereof notwithstanding the express or tacit renunciation by the debtor or proprietor.

COMMENT:**(1) Right of Creditors to Make Use of Prescription**

Reason for the law:

While rights may be waived, third persons with a right recognized by law should not be prejudiced. (*Art. 6, Civil Code*).

(2) Example

Tom who is indebted to Nicole acquired a parcel of land by prescription. If Tom renounces the prescription, may Nicole make use of said land?

ANS.: Yes, to the extent of her credit, if Tom is not able to pay his debt. Tom is not allowed to prejudice Nicole.

Sambrano v. Court of Tax Appeals, et al.
101 Phil. 1

FACTS: Although the right of the State to collect the taxes had already been extinguished by prescription, taxpayer Sambrano nevertheless executed a chattel mortgage on his properties to guarantee the payment of the same. As a matter of fact, he actually paid part of the debt. *Issue:* Can Sambrano later on raise the issue of prescription?

HELD: No more, for his actuations amount to a renewal (*renovacion*) of the obligation or to a waiver of the benefit granted by the law to him. He is, therefore, now estopped from raising the issue of prescription. Moreover, the Court said that a prescribed debt may be the subject of novation. (*Estrada v. Villaroel, 40 O.G. Supp. No. 5, 9, p. 201*).

Art. 1115. The provisions of the present Title are understood to be without prejudice to what in this Code or in special laws is established with respect to specific cases of prescription.

COMMENT:**(1) Specific Provisions on Prescription**

Specific provisions on prescription found elsewhere in the Code, or in special laws, prevail over the provisions of this

Chapter. This is particularly true in the instances when specific periods of prescription are provided for.

(2) Examples

- (a) A legitimate child may bring an action to claim legitimacy as long as *he is alive* (generally). (*Art. 173, Family Code*).
- (b) An illegitimate child may bring an action to establish illegitimate filiation during his lifetime (generally). (*Art. 175, Family Code*).
- (c) The real right of possession of real property is lost at the end of 10 years.
- (d) The proceeding for the probate of a will never prescribes. (*Guevara v. Guevara, et al., L-5405, Jan. 31, 1956*).
- (e) The proceeding for the deportation of an alien must be brought within five years from the date the cause for deportation arose. (*Sec. 37, Immigration Act*).

[Thus, where an alien entered the Philippines illegally in 1998, but he violated the Immigration Law in 2004 by bringing in his wife who was *not* lawfully entitled to enter or reside in the Philippines, the deportation proceeding commenced in 2005 had not prescribed. This is because the cause accrued in 1999. (*See Porta Perez v. Board, L-9236, May 29, 1957*).]

- (f) An action to annul a sale of shares of stock in a corporation is violation of the Securities Act because there was no permit for the same, and for the recovery of the purchase price must be instituted within a period of *two years* from the date of the sale. Hence, if the sale is made on Oct. 23, 2003, but the action is brought on Nov. 2, 2005, the action is 10 days late, and can no longer be entertained. (*See Benedicto v. Phil. American Finance and Development Co., L-8695, May 31, 1957*).
- (g) In order to confer jurisdiction on the Court of Tax Appeals, the suit for *refund* of taxes *erroneously* or *illegally assessed* must be brought within the statutory period of *two years*, and the requirements provided in the National Internal

Revenue Code must be complied with. (*Collector of Internal Revenue v. Court of Tax Appeals, et al.*, L-11494, Jan. 28, 1961).

- (h) An action for accounting or reliquidation of agricultural crops under par. 3, Sec. 17 of Rep. Act 1199 should be brought within 3 years from the threshing of the crops in question. (*Agaton Mateo v. Gregorio Duran, et al.*, L-14314, Feb. 22, 1961).

Art. 1116. Prescription already running before the effectivity of this Code shall be governed by laws previously in force; but if since the time this Code took effect the entire period herein required for prescription should elapse, the present Code shall be applicable, even though by the former laws a longer period might be required.

COMMENT:

(1) Transitional Rules for Prescription

- (a) If the period for prescription BEGAN and ENDED under the OLD laws, said OLD laws govern.
- (b) If the period for prescription BEGAN under the NEW Civil Code, the NEW Civil Code governs.
- (c) If the period began under the OLD law, and continues under the NEW Civil Code, the OLD law applies.

Exception:

In this third rule, it is the NEW Civil Code that will apply, provided two conditions are present:

- 1) The NEW Civil Code requires a *shorter* period;
- 2) This shorter period has already elapsed since Aug. 30, 1950, the date when the NEW Civil Code became effective.

(Thus, the period prescribed under the NEW Code should be counted from Aug. 30, 1950. However, if by this method a longer period would be needed, a

period that is even longer than that provided under the OLD law, said OLD law applies).

(2) Example of the First Rule Given

**Paz Ongsiaco and the Heirs of the
Late Augusto Ongsiaco v. Roman D. Dallo, et al.
L-27451, Feb. 28, 1969**

FACTS: A complaint was filed in 1966 against the family of Paz Ongsiaco for recovery of the ownership of a parcel of land in Cuyapo, Nueva Ecija. It was admitted by claimants that since 1924 (42 years before the basic complaint was filed in 1966), said family had been in possession of the land and that said possession was really adverse or in the concept of owner. However, it was alleged that the possession was in BAD FAITH. *Issue:* May recovery of the property be allowed?

HELD: Recovery cannot be allowed for the cause of action *has already prescribed*. Under Art. 1116, in a case like this, the law in force before the New Civil Code should apply. It is clear that under such old law, the Code of Civil Procedure, *good or bad faith was immaterial* for purposes of acquisitive prescription. (*Sec. 41*). Moreover, even the thirty-year period fixed in the New Civil Code for the acquisition in bad faith by prescription of real property had already expired when this case was filed in 1966.

(3) Example of the Third Rule Given

BAR

A, with knowledge that *B* is not the owner of a parcel of land, buys it for a nominal sum from *B* in 1944, and since then has been in open, actual, continuous, and public possession thereof, under claim of title exclusive of any other rights and adverse to all other claimants. *C*, the real owner of the land, who has left in 1944 by reason of the war, was able to return to the land only in 1958 and learning of *A*'s possession, files suit. *A* claims prescription of ten years, because he took possession of the land before the new Civil Code; but *C* counters that as

A entered the land in bad faith, and he had not yet acquired ownership by the time the New Civil Code took effect, the period is *thirty years* under the New Code. Decide with reasons.

ANS.: Inasmuch as here the prescription was already running before Aug. 30, 1950, it follows that only 10 years would be required because under the Code of Civil Procedure, *regardless of good faith or bad faith*, the period for acquiring land by prescription was only 10 years. (*Sec. 41, Act 190, Code of Civil Procedure and Osorio v. Tan Jongko, 51 O.G. 6221*). It, therefore, follows necessarily that in 1954, A had already acquired the property by acquisitive prescription. Hence, C should lose the case, unless of course the land is covered by a Torrens Certificate of Title. (*Osorio v. Tan Jongko, supra*).

The period of 10 years must necessarily start from 1944, and not from Aug. 30, 1950, since here, the prescriptive period under the OLD law was SHORTER. Had the period under the old law been LONGER, it is the shorter period under the new Civil Code that should apply, but this time, the period should *commence* from the date of effectivity of the new Civil Code — Aug. 30, 1950 — in view of the clause “but if since *the time this Code took effect . . .*”

(4) Example of the Exception

Under the old law the period was 10 years (as in the case of reduction of a donation of land on the ground of *birth* of a child), but under the New Civil Code, the period is only 4 years, counted from the birth of the first child. (*Art. 763*). It is clear here that the New Civil Code (4 years) will apply, even if the donation and the birth occurred under the old law, but the period should be counted from Aug. 30, 1950, unless in so doing, a period of more than 10 years would result.

(5) Some Doctrines

- (a) In *Estayo v. De Guzman, L-10902, Dec. 29, 1958*, the Supreme Court held that when the action to enforce the mortgage presented as an appeal bond in a court action became effective by the entry of the judgment of the Supreme Court on Aug. 6, 1940, the encumbrance may be cancelled after Aug. 6, 1950.

- (b) In *Ongsiako, et al. v. Ongsiako, et al.*, L-7510, Mar. 30, 1957, the Supreme Court held that Art. 1116 (Civil Code) prevails over the general transitory rule in Art. 2258 (Civil Code) which provides that actions and rights which came into being but which were not exercised before the effectivity of the Code, shall remain in full force in conformity with the old legislation, but the exercise, duration, and procedure to enforce them shall be regulated by the Rules of Court.
- (c) In *Borromeo v. Zaballero*, L-14357, Aug. 31, 1960, a promissory note was executed in 1935, payable in 1937. The claim for payment was presented in the settlement of the estate of the deceased debtor in Sept. 1955. The Court ruled that the ten-year period of prescription under Act 190 had already lapsed.
- (d) In *Nagrampa, et al. v. Nagrampa*, L-15434, Oct. 31, 1960, the Court observed that under the old law, no special period of prescription was fixed for the revocation of donations for non-compliance with the conditions stipulated. However, under the New Civil Code (Art. 764), the period fixed for such a case is 4 years. The suit was filed in July, 1958, alleging that the plaintiffs had demanded compliance “five years ago, but the defendant refused.” The Court held that the entire period of four years fixed by the New Civil Code has elapsed since it took effect in 1950. Suit was filed only in July, 1958 for a violation made in 1953.
- (e) In *Amar v. Odianan*, L-15179, Sept. 30, 1960, a complaint for the recovery of land was filed in November, 1948, alleging that in April, 1948, the land had been seized by the defendant by means of fraud, deceit, and strategy. It was held that the old law, Sec. 40 of Act 190 (which provided that an action for the recovery of real property can only be brought within 10 years) was applicable, and that therefore, the action has already prescribed.
- (f) In *PNB v. Galicano Ador Dionisio*, L-18342, Sept. 19, 1963, it was held that a judgment that had become final in 1949 could *not* be revived anymore in 1960 (lapse of more than 10 years), despite written extrajudicial demand in 1954 for the satisfaction of the judgment. This is because this

case is governed *not* by Art. 1155 of the Civil Code, but by Sec. 50 of the Code of Civil Procedure (which section does *not* state that such written extrajudicial demands interrupt the prescriptive period). The old law applies because Art. 1116 says “prescription *already* running before the effectivity of this Code shall be governed by laws previously in force . . .”

Chapter 2

PRESCRIPTION OF OWNERSHIP AND OTHER REAL RIGHTS

Art. 1117. Acquisitive prescription of dominion and other real rights may be ordinary or extraordinary.

Ordinary acquisitive prescription requires possession of things in good faith and with just title for the time fixed by law.

COMMENT:

(1) Requisites Common to Ordinary and Extraordinary Prescription

- (a) capacity of *acquirer* to acquire by prescription
- (b) capacity of *loser* to lose by prescription
- (c) object must be susceptible of prescription
- (d) lapse of required period of time
- (e) the possession must be:
 - 1) in *concepto de dueño* (concept of owner)
 - 2) public (not clandestine or non-apparent)
 - 3) peaceful (not thru force, violence, or intimidation)
 - 4) continuous or uninterrupted

[NOTE: Under the old law — the Code of Civil Procedure whether the possession was in good faith or in bad faith did not matter. The period for immovables was always 10 years. Also, the possession need not be peaceful. (See Arboso v. Andrade, 87 Phil. 782). However, the possession, even under the old law

had to be uninterrupted, actual, exclusive, and not merely tolerated. (*See Pascual v. Mina*, 20 Phil. 202 and *Villanueva v. Protacio*, CA-GR 7591-R, Mar. 22, 1955).]

(2) Additional Requisites

- (a) for ORDINARY prescription
 - 1) good faith
 - 2) just title (there was a *mode* of acquiring ownership but the grantor was *not* the owner; hence, the just title here is “*titulo colorado*” or “colorable title”).
- (b) for EXTRAORDINARY prescription (no other requisites except those mentioned in Comment No. 1 under this Article are required).

Art. 1118. Possession has to be in the concept of an owner, public, peaceful and uninterrupted.

COMMENT:

(1) Characteristics of the Possession Needed for Prescription

See this Article. See also the comments in the preceding Article.

(2) Possessor in the Concept of Holder

A possessor in the concept of holder cannot acquire property by prescription because his possession is *not* adverse. Thus, the possession of land in the capacity of *administrator* (mere holder) cannot ripen into ownership. (*Ranjo v. Payoma*, L-1866, May 30, 1951). Neither is the possession by a mortgagee adverse. (*Garcia v. Arjona*, L-7279, Oct. 29, 1955).

(3) Owner-Administrator

The mere fact that the person who claims ownership of the property *also administers* the same does not militate against its acquisition of the property by prescription. The fact that he

stated that he administered the properties in question does not necessarily imply that he is not the owner thereof for certainly an owner of a property can be its own administrator. (*Guarin, et al. v. De Vera, L-9577, Feb. 28, 1957*).

Art. 1119. Acts of possessory character executed in virtue of license or by mere tolerance of the owner shall not be available for the purposes of possession.

COMMENT:

Possession by License or Tolerance of Owner

In possession by *license* or *tolerance*, there is implied recognition of ownership residing in ANOTHER. (*See Macaldao v. Castro, CA-GR 22408-R, Aug. 12, 1963*).

Art. 1120. Possession is interrupted for the purposes of prescription, naturally or civilly.

COMMENT:

(1) How Possession Is Interrupted for Purposes of Prescription

- (a) naturally. (*Arts. 1121, 1122, Civil Code*).
- (b) civilly. (*Arts. 1123, 1124, Civil Code*).

(2) Natural Interruption

If prescription is *interrupted*, the old possession will *generally* not be counted; the period must begin all over *again*.

(3) Suspension of Prescription

If prescription is *merely suspended* (as distinguished from *interruption*), the old possession will be ADDED. This may happen when during war, the civil courts are NOT open (*Arts. 1136, Civil Code*); or when there is a moratorium on the payment of debts. (*Talens, et al. v. Chuakay and Co., GR L-10127, Jun. 30,*

1958 and *Rio and Co. v. Datu Jolkipli*, GR L-12301, Apr. 13, 1959).

Art. 1121. Possession is naturally interrupted when through any cause it should cease for more than one year.

The old possession is not revived if a new possession should be exercised by the same adverse claimant.

COMMENT:

(1) ‘Natural Interruption’ Defined

The definition is implied in the first paragraph. Note the phrase “any cause.”

(2) Reason for the Period Involved

Possession *de facto* is lost if the property be in the possession of another for more than one year. Hence, if the possession of another has been for *one year or less*, it is as if there was no interruption. (*Art. 1122, Civil Code*).

(3) Reason for the Non-Revival of the Possession

Possession here must be continuous and not interrupted.

Art. 1122. If the natural interruption is for only one year or less, the time elapsed shall be counted in favor of the prescription.

COMMENT:

The Article explains itself.

Art. 1123. Civil interruption is produced by judicial summons to the possessor.

COMMENT:

‘Civil Interruption’ Defined

The definition is implicit in the Article.

Art. 1124. Judicial summons shall be deemed not to have been issued and shall not give rise to interruption:

- (1) If it should be void for lack of legal solemnities;**
- (2) If the plaintiff should desist from the complaint or should allow the proceedings to lapse;**
- (3) If the possessor should be absolved from the complaint.**

In all these cases, the period of the interruption shall be counted for the prescription.

COMMENT:

(1) When Judicial Summons Cannot Be Considered Civil Interruption

Three instances are given in the Article.

NOTE: If the possessors are sued, but emerge *victorious*, it is as if there was no interruption during the period of the suit. (*Lacuesta v. Guerrero*, 8 *Phil.* 719).

(2) Apparent Interruption

In the three cases given above, it is as if there was NO interruption. "Interruption" in the last sentence should therefore read as "*apparent interruption*" since under the law there was never an interruption. (See first sentence).

(3) Applicability to Acquisitive, Not Extinctive Prescription

In *Amar v. Odianan* (L-15179, Sept. 30, 1960), the Court held that Arts. 1943, 1945, and 1946 of the *old Civil Code* (and from which Arts. 1120, 1123, and 1124 of the *New Civil Code* were taken), refer to interruption of possession in relation to *acquisitive* prescription, and not to cases of *extinctive* prescription.

Art. 1125. Any express or tacit recognition which the possessor may make of the owner's right also interrupts possession.

COMMENT:**(1) Recognition by Possessor of Owner's Right**

Reason for the Article — Here the possession is *no* longer in *concepto de dueño* or *adverse*.

(2) Example

The act of a government official, duly authorized to so act, in recognizing ownership of land in a private person, interrupts possession by the municipality concerned. (*Seminary of San Carlos v. Mun. of Cebu*, 19 Phil. 32).

Art. 1126. Against a title recorded in the Registry of Property, ordinary prescription of ownership or real rights shall not take place to the prejudice of a third person, except in virtue of another title also recorded; and the time shall begin to run from the recording of the latter.

As to lands registered under the Land Registration Act, the provisions of that special law shall govern.

COMMENT:**(1) Prescription of Titles Recorded in Registry of Property**

- (a) It is clear that Art. 1126 does NOT refer to land registered under the Land Registration Law (with a Torrens Title).
- (b) It, however, refers to all other lands.
- (c) *Example:*

Arcadio is the owner of land *not* protected by a Torrens Title. His right is, however, duly registered in the Registry (for the deed of sale in his favor has been duly registered).

- 1) If Artemio, a stranger, takes possession of the land in good faith (from a seller-forger), is there a chance for him to become, after 10 years, the owner of the land, as against Arcadio?

ANS.: Yes, after all, Arcadio is not protected by a Torrens Title. He certainly is *not* the third person referred to in the Article. (*See Sison v. Ramos, 13 Phil. 54*). Thus, as between Arcadio and Artemio, Artemio becomes the owner at the end of 10 years.

- 2) Suppose 12 years after Artemio takes possession, Arcadio sells the land to Benedicto, an innocent purchaser for value (who, in investigating Arcadio's title found that the property was indeed registered in Arcadio's name), will Benedicto become the owner?

ANS.: Yes, for insofar as the *innocent world* was concerned, Arcadio was still the owner at the time he sold it to Benedicto. He could therefore validly transfer ownership to Benedicto. Artemio's prescriptive right should clearly *not* prejudice Benedicto.

(NOTE: If Artemio had caused his title to be registered, he could have become the owner insofar as the entire world was concerned, *not* from the time he registered the forged deed of sale in his favor but from the time of the lapse of 10 years after such recording. What begins to run from such recording is *not* the ownership, but the period or time for prescription.)

(2) Lands Registered Under the Land Registration Law

Lands registered under the Torrens system cannot be acquired by prescription (*Alfonso v. Jayme, L-12754, Jan. 30, 1960*) but this rule can be invoked only *by one under whose name* (or under whose predecessor's name) *it was registered*. (*Jocson, et al. v. Silos, L-12998, July 25, 1960*).

Alfonso v. Jayme L-12754, Jan. 30, 1960

FACTS: Plaintiff's land, protected by a Torrens Title, was taken by Pasay City for conversion into a road in 1925, *without* compensation. In 1954, plaintiff sued for recovery of the land or its value.

HELD: Since the land was under his name under the Torrens system, plaintiff remained owner, and could recover posses-

sion at any time. However, because it is now a ROAD, it is not convenient to restore it to plaintiff. Pasay City was ordered to pay compensation based on the value of the land in 1925, with legal interest as damages.

Jocson, et al. v. Silos
L-12998, Jul. 25, 1960

FACTS: A widower sold *conjugal* property, registered under *his name* under the Torrens system, to an innocent purchaser for value, who was subsequently given or issued a new transfer certificate of title, under his (the buyer's) name. *Twenty-two* years later, the heirs of the deceased spouse (the wife) sued for annulment of the sale with respect to one-half of the land.

HELD: The suit for annulment and recovery has already prescribed. The claim of imprescriptibility would have been correct if the land had been registered in the name of the *husband and wife*, not in the name of the husband alone.

Art. 1127. The good faith of the possessor consists in the reasonable belief that the person from whom he received the thing was the owner thereof, and could transmit his ownership.

COMMENT:

‘Good Faith of Possessor’ Defined

Note that the definition here of good faith applies in connection with *prescription*.

Art. 1128. The conditions of good faith required for possession in Articles 526, 527, 528, and 529 of this Code are likewise necessary for the determination of good faith in the prescription of ownership and other real rights.

COMMENT:

(1) Other Requisites for Good Faith

The requisites in the Articles mentioned must ALL be present — otherwise there is no good faith.

- (a) Art. 526. He is deemed a possessor in good faith who is not aware that there exists in his title or mode of acquisition any flaw which invalidates it.

He is deemed a possessor in bad faith who possesses in any case contrary to the foregoing.

Mistake upon a doubtful or difficult question of law may be the basis of good faith.

- (b) Art. 527. Good faith is always presumed, and upon him who alleges bad faith on the part of a possessor rests the burden of proof.
- (c) Art. 528. Possession acquired in good faith does not lose this character except in the case and from the moment facts exist which show that the possessor is not unaware that he possesses the thing improperly or wrongfully.
- (d) Art. 529. It is presumed that possession continues to be enjoyed in the same character in which it was acquired, until the contrary is proved.

(2) For How Long the Good Faith Must Last

The good faith must last throughout the required period.
(TS, Jan. 25, 1945).

(3) Good Faith Changing to Bad Faith

It is, however, possible that the good faith may later change to bad faith. In such a case, how many more years of possession would be required?

ANS.:

- (a) For real property, *three* years of possession in *bad* faith would be equivalent to *one* year of possession in good faith.

(Reason: 30 years would be required for extraordinary prescription, but only 10 years are needed for ordinary prescription).

- (b) For personal property, two years of possession in *bad* faith would be equivalent to *one* year in good faith.

(*Reason:* Extraordinary prescription needs 8 years; ordinary prescription, 4 years).

Art. 1129. For the purposes of prescription, there is just title when the adverse claimant came into possession of the property through one of the modes recognized by law for the acquisition of ownership or other real rights, but the grantor was not the owner or could not transmit any right.

COMMENT:

‘Just Title’ Defined

- (a) The definition is implied in the Article.
- (b) See Comments under the next Article.

Art. 1130. The title for prescription must be true and valid.

COMMENT:

Nature of the Title Required

- (a) What is really meant by *just title* is “*titulo colorado*,” that is, there was a mode of acquisition but the grantor was *not* the owner. Had he been the owner, there would be no more necessity for prescription. (*See Doliendo v. Biarnesa*, 7 Phil. 232; *see also Genova v. Cariobaldes*, CA-GR 15945-R, Mar. 25, 1957, 53 O.G. 4511).
- (b) “True and valid” as used in Art. 1130 does not mean one without any defect, for in such a case, there would be no necessity for prescription. What it means is that the *mode* should ordinarily have been valid and true, had the grantor been the owner. (*Doliendo v. Biarnesa*, 7 Phil. 232; 2 *Castan* 240). Thus, if aside from the defect of the grantor not being the owner, there is *another* defect that would render the acquisition *void*, the title thus acquired would *not* be sufficient for ordinary prescription. Such for example would be the case if the contract were *absolutely simulated*; or when

a husband, *pretending* to be the owner of certain property, would *donate* it to his paramour. *Even if* the husband had been the owner, the donation would have been null and void just the same. Here, the donee, lacking “just title,” can acquire ownership by *extraordinary*, *not* by ordinary prescription.

Art. 1131. For the purposes of prescription, just title must be proved; it is never presumed.

COMMENT:

Necessity of Proving the Just Title

- (a) Proof is needed in view of the *aggressive* or *offensive* character of prescription.
- (b) In prescription, therefore, the presumption of just title given under Art. 541 regarding DEFENSE of rights does *not* apply. (*See 2 Castan 241*).

Art. 1132. The ownership of movables prescribes through uninterrupted possession for four years in good faith.

The ownership of personal property also prescribes through uninterrupted possession for eight years, without need of any other condition.

With regard to the right of the owner to recover personal property lost or of which he has been illegally deprived, as well as with respect to movables acquired in a public sale, fair, or market, or from a merchant’s store the provisions of Articles 559 and 1505 of this Code shall be observed.

COMMENT:

(1) Period of Prescription for Movables

This Article states the rules for MOVABLES:

- (a) ordinary prescription — 4 years
- (b) extraordinary prescription — 8 years

(2) Rule with Respect to Lost Movable and Those of Which the Owner Has Been Illegally Deprived

The possession of movable property acquired in good faith is equivalent to a title. Nevertheless, one who has lost any movable or has been unlawfully deprived thereof, may recover it from the person in possession of the same.

If the possessor of a movable lost or of which the owner has been unlawfully deprived, has acquired it in good faith at a public sale, the owner cannot obtain its return without reimbursing the price paid therefor. (*Art. 559, Civil Code*).

(3) Rule with Respect to Public Sales, Fairs, Markets, and Merchant's Store

Subject to the provisions of this Title, where goods are sold by a person who is not the owner thereof, and who does not sell them under authority or with the consent of the owner, the buyer acquired no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell.

Nothing in this Title, however, shall affect:

- (a) The provisions of any factors' acts, recording laws, or any other provision of law enabling the apparent owner of goods to dispose of them as if he were the true owner thereof;
- (b) The validity of any contracts of sale under statutory power of sale or under the order of a court of competent jurisdiction;
- (c) Purchases made in a merchant's store, or in fairs, or markets, in accordance with the Code of Commerce and special laws. (*Art. 1505, Civil Code*).

Art. 1133. Movable possessed through a crime can never be acquired through prescription by the offender.

COMMENT:**(1) Movable Possessed Through a Crime**

Note the word "offender." By implication, subsequent acquirers from the "offender" may acquire the property by prescription.

(2) Rule for Immovables (Where Crimes Are Involved)

Regarding *immovables*, possession by *force* or *violence* does not give rise to prescription.

Art. 1134. Ownership and other real rights over immovable property are acquired by ordinary prescription through possession of ten years.

COMMENT:**Prescriptive Periods for Acquiring Real Property**

This Article and the following ones state the rule for IMMOVABLES:

- (a) ordinary prescription — 10 years
- (b) extraordinary prescription — 30 years. (*Art. 1137, Civil Code*).

Art. 1135. In case the adverse claimant possesses by mistake an area greater, or less, than that expressed in his title, prescription shall be based on the possession.

COMMENT:**When Area Possessed Varies from Area in Title**

- (a) The term “possesses” here refers to both *actual* and *constructive* possession, since possession in the eyes of the law does not mean that a man has to have his feet on every square meter of land. (*Ramos v. Dir. of Lands, 39 Phil. 175*).
- (b) Notice that “possession” here prevails over the “title.” Necessarily, if there is NO title, the Article cannot apply.
- (c) The possession here must be “by mistake.”

Art. 1136. Possession in wartime, when the civil courts are not open, shall not be counted in favor of the adverse claimant.

COMMENT:**(1) Possession in War Time**

- (a) The Article does not apply when the civil courts are open. In *Rio y Compania v. Datu Jolkipli, L-12301, April 13, 1959*, the Supreme Court held that the statute of limitations is suspended if during wartime, courts are not or cannot be kept open. However, to invoke this rule, a party must first show that the court was closed or could not be opened for business as a consequence of chaos and confusion. The determination of this matter is a question of fact, which should be ventilated in the hearing of a case on the merits.
- (b) During the Japanese occupation, there were places in the Philippines where no civil courts could function.

(2) Fortuitous Event — Effect on Prescription

Note that under Art. 1154 of the Civil Code, “the period during which the obligee was prevented by a fortuitous event from enforcing his right is not reckoned against him.”

Art. 1137. Ownership and other real rights over immovables also prescribe through uninterrupted adverse possession thereof for thirty years, without need of title or of good faith.

COMMENT:**(1) Extraordinary Prescription With Respect to Immovables**

This Article refers to extraordinary prescription regarding:

- (a) ownership over immovables
- (b) other real rights over immovables

(2) Period Required

Note the period — 30 years.

(3) What Are Not Needed

Under this Article, neither good faith nor just title is essential; hence, property *voidly* donated may be acquired by *extraordinary prescription*. This may for instance occur when the donation of real properties had *not* been validly accepted by the donee. Although here the donation is void, it may be the basis for the acquisition of the donee of said properties by prescription. (*Guarin, et al. v. De Vera, L-9577, Feb. 28, 1957 and Pensader v. Pensader, 47 Phil. 959*).

(4) Retroactive Effect of the Prescription

Prescription has a *retroactive* effect, that is, the acquirer, as soon as the necessary period has lapsed, is considered the owner from the BEGINNING of the possession. Thus, any encumbrances made by him during said period should be considered as valid, while those of the original *owner* are not binding on the acquirer by prescription. The acquirer is also entitled to all the fruits during said period in view of his retroactive ownership. (*2 Castan 254-255*).

Art. 1138. In the computation of time necessary for prescription, the following rules shall be observed:

(1) The present possessor may complete the period necessary for prescription by tacking his possession to that of his grantor or predecessor in interest;

(2) It is presumed that the present possessor who was also the possessor at a previous time, has continued to be in possession during the intervening time, unless there is proof to the contrary;

(3) The first day shall be excluded and the last day included.

COMMENT:

Rules for Computation of Time

Par. 1 — *Tacking of Possession*

- (a) This means ADDING the period of possession of the predecessor. *Reason:* The true owner of the property was

after all NOT in possession, during the possession of said predecessor.

- (b) *Tacking* is allowed *only* if there be privity of relationship between the predecessor and the successor, as in the case of succession, donation, sale, barter, etc. Thus, a mere intruder or usurper cannot “tack.” (*See Razote v. Razote*, 14 Phil. 182; *Lacson v. Gov’t.*, 39 Phil. 63).
- (c) “Tacking” by a subsequent possessor of his predecessor’s possession can be allowed if the predecessor’s possession *can satisfy* the requisites for prescription (such as the fact that the possession must be in the concept of owner, peaceful, etc.). (*See 2 Corpus Juris* 92 and *Casilag v. Fajardo*, CA-GR 1066-R Jun. 18, 1948, 46 O.G. 570).

Par. 2 — *Presumption of Continuing Possession*

The presumption is expressly declared to be rebuttable.

Chapter 3

PRESCRIPTION OF ACTION

Art. 1139. Actions prescribe by the mere lapse of time fixed by law.

COMMENT:

(1) How Actions Prescribe

By the *mere lapse of the time* indicated in the law. There is no other requirement.

(2) Scope or Nature of the Chapter

This chapter is our *general* Statute of Limitations, because particular provisions on prescription naturally prevail. (*See Art. 1148, Civil Code*).

(3) Prescription as a Defense

In general, we may say that the prescription of action is available as a DEFENSE. To be asserted as such, it must be specifically *pleaded and proved*. (*Hodges v. Salas, 63 Phil. 567*). Thus, if not set up or pleaded as a defense, proof cannot later on be presented if objection is made to the introduction of such proof. (*National Bank v. Escudero, 92 Phil. 150*). Upon the other hand, as long as the defendant raised the defense of prescription in his answer to the complaint, but the complaint was dismissed on some other ground, he can still set up in his *brief* in the appellate court in an appeal by the plaintiff from the decision of the trial court. (*Lapuz v. Sy Uy, L-10079, May 17, 1957*). If the issue of prescription can be decided from the averments of the pleadings, more particularly from the plaintiff's complaint, there is NO necessity of receiving evidence on the matter, before the

Court may dismiss the complaint on the ground of prescription. (*Bambao, et al. v. Lednický, et al.*, L-15495, Jan. 28, 1961).

(4) Effect of Death on Prescription

If a *father* has a cause of action against a stranger (the period of prescription of which is, let us say, 4 years) and the father dies before the end of such prescriptive period, should prescription continue to run, even if say his children are still MINORS? The Supreme Court in the case of *Martir, et al. v. Trinidad, et al.*, L-12057, May 20, 1959, answered YES, for after all in this case the cause of action accrued in favor of the father himself, and not directly in favor of the children. Except where a statute provides otherwise, one disability (like the father's death) CANNOT be *tacked* to another's disability (like the children's minority). Nor can a party avail himself of several disabilities, unless they all existed at the time when the right of action accrued. This is in obedience to the universal rule that when a Statute begins to run, no subsequent disability can stop its operation unless specially so provided in the statute.

(5) Conflict of Laws — Variance of Foreign and Local Law Re Prescription

In the case of *D'Almeida v. Hagedorn* (L-10804, May 22, 1957), an action was brought in 1954 in the Philippines on two demand notes executed in 1942 and 1943 in Hong Kong where both debtor and creditor were residing until liberation. The Court, in applying the rule that the moratorium law suspended the running of the prescriptive period and that therefore the action had *not* prescribed, ruled that prescription is governed by the law of the *forum*. It would seem from this ruling that even if the cause of action accrued in Hong Kong and has already prescribed under Hong Kong law, it has *not yet* prescribed under Philippine law. This seems to lose sight of a section of Act 190 (Code of Civil Procedure) which states that "if, by the laws of the State or country where the cause of action arose, the action is barred, it is also barred in the Philippines." In the instant case, however, there was *no proof* that the claim was barred under Hong Kong law, and it is well-settled that in the absence of proof of the foreign law, it is presumed to be the same as Philippine law.

(NOTE: The presumption has been referred to as a “propositional presumption”).

(6) How Long Is a Month?

Quizon v. Baltazar 76 SCRA 560

The term “month” as used in a law (such as Art. 90 of the Revised Penal Code) is understood to refer to a *30-day month* and not to a calendar month.

(7) Query

Does a property deemed part of the public forest prescribe?

ANS.: An action for reversion filed by the State to recover property registered in favor of any party which is part of the public forest *or* of a forest reservation never prescribes. (*Heirs of the Late Spouses Pedro S. Palanca and Soteranea Rafols Vda. De Palanca v. Republic*, 500 SCRA 209 [2006]).

Art. 1140. Actions to recover movables shall prescribe eight years from the time the possession thereof is lost, unless the possessor has acquired the ownership by prescription for a less period, according of Article 1132, and without prejudice to the provisions of Articles 559, 1505, and 1133.

COMMENT:

Recovery of Movables

This refers to extraordinary prescription for *movables*.

Art. 1141. Real action over immovables prescribe after thirty years.

This provision is without prejudice to what is established for the acquisition of ownership and other real rights by prescription.

COMMENT:**Recovery of Immovables**

- (a) This refers to extraordinary prescription for *immovables*.
- (b) The possession *de jure* of an immovable is lost, however, at the end of 10 years. (*No. 4, Art. 555, Civil Code*).

**De Jesus, et al. v. CA, et al.
GR 57092, Jan. 21, 1993**

Prescription running even after the effectivity of the New Civil Code on August 30, 1950, continued to be governed by Sec. 41 of the Old Civil Code.

Under the present Civil Code, the prescriptive period required for the acquisition of immovable property is 10 years if the possession is in good faith, and 30 years if in bad faith. Such open, continuous, exclusive and notorious occupation of the disputed property for 30 years must be conclusively established.

Reckoned from the time she executed the affidavit of adjudication in 1961, eleven years after the New Civil Code had taken effect, private respondent's possession of the contested lot is far too short of the prescriptive period of 30 years, considering that her possession is in bad faith. The filing of the petition for recovery of ownership and possession and quieting of title by petitioners on Apr. 27, 1973 was well below the acquisitive prescriptive period for private respondent, which is 30 years under Art. 1141 of the present Civil Code. In this case, the statutory period of prescription is deemed to have commenced when petitioners were made aware of a claim adverse to them, *i.e.*, when the affidavit of adjudication was duly registered with the Registry of Deeds which, at the earliest may be considered to be in 1974, when private respondent was able to secure a tax declaration in her name.

Art. 1142. A mortgage action prescribes after ten years.

COMMENT:**(1) Prescription of Mortgage Actions**

10 years.

(2) When Period Begins

From what moment must the 10-year period be counted? From the day on which it could have been brought. (*Art. 1150, Civil Code*). Thus, if the parents of an employee should execute a real estate mortgage to secure a performance bond given by a surety company for their son, the period of prescription begins from the moment the surety company *pays* by reason of said bond because from said date, the mortgagors become liable, and foreclosure can be made. (*Nabong v. Luzon Surety Co., Inc., L-10034, May 17, 1957*).

(3) Lands With a Torrens Title

While lands with a Torrens Title cannot be acquired by prescription (*Sec. 39, Act 496 and Rosario v. Aud. General, L-11817, Apr. 30, 1958*), still the right to foreclose a mortgage on such lands *does prescribe* for what does not prescribe is the *ownership* of said lands.

(4) Effect if Mortgage Is Registered

Even if a mortgage is *registered*, the action to foreclose upon it may still prescribe. (*Buhat v. Besana, 50 O.G. 4215, Sept. 1954*).

(5) Effect on Interest on Debt

If a mortgage debt had already prescribed, so also has the action to recover interest thereon. (*Soriano v. Enriquez, 24 Phil. 584*).

Art. 1143. The following rights among others specified elsewhere in this Code, are not extinguished by prescription:

- (1) To demand a right of way, regulated in Article 649;**
- (2) To bring an action to abate a public or private nuisance.**

COMMENT:**(1) Rights Not Extinguished by Prescription**

- (a) Two rights are indicated in the Article. [The first right, the demanding of the right of way, would seem to cover

also the right to demand a *compulsory or legal easement of drainage*. (*See Art. 676, Civil Code*.)]

- (b) Reason for the non-prescriptibility: public policy.

(2) Some Other Actions That Do Not Prescribe

- (a) The action to demand partition of a co-ownership (as long as the co-ownership has been expressly or implicitly recognized). (*Art. 494, Civil Code*).

Budiong v. Pandoc 79 SCRA 24

The right to demand partition does not prescribe. (*See Art. 494 of the Civil Code*).

- (b) The action (or the defense) for the declaration of *contract of marriage* as null and void or inexistent. (*See Art. 1410; see also Banaga v. Soler, L-15717, Jun. 30, 1961*).
- (c) The action to have a will probated (otherwise, the desires of the deceased, who cannot help himself, may be frustrated). (*Guevara v. Guevara, et al., L-05405, Jan. 31, 1956*).
- (d) The action for the quieting of title so long as the plaintiff is in possession of the property. (*Sapto, et al. v. Fabiana, L-11285, May 6, 1958*).
- (e) The right to demand support (present and future), but installments on support in arrears may prescribe. (*Trinidad Florencio v. Rufino Organo, GR L-4037, Nov. 29, 1951*).
- (f) Generally, an action to recover property *expressly placed in trust* (express trust) cannot prescribe in view of the confidence reposed, UNLESS such trust has been repudiated unequivocally. However, constructive trusts are affected by prescription and laches in view of the lack of confidence or fiduciary relations. (*Diaz, et al. v. Garricho and Agriado, L-11229, Mar. 20, 1958; see Bachrach Motor Co. v. Lejano, L-10910, Jan. 16, 1959; see also comments under Art. 1456, this Volume*).

- (g) An action to compel reconveyance of property with a Torrens Title does NOT prescribe if the registered owner had obtained registration in *bad faith*, and the property is still in the latter's name. The reason is that the registration is in the nature of a continuing and subsisting trust. (*Caldiao v. Vda. de Blas*, L-19063, Apr. 29, 1964). However, if the property has already passed to an innocent purchaser for value, the principle of imprescriptibility does *not* apply. (*Ibid.*). NOTE: In *Gerona, et al. v. Carmen de Guzman, et al.*, L-19060, May 29, 1964, however, the Supreme Court stated that although there are some decisions to the contrary, it is already settled that an action for reconveyance of real property based upon a constructive or implied trust, resulting from fraud, may be *barred* by prescription. The period is 4 years from the discovery of the fraud.
- (h) An action brought by a buyer of land to compel the seller to execute the proper deed of conveyance does NOT prescribe, provided that said buyer is still in POSSESSION. (*See Castrillo v. Court of Appeals*, L-18046, Mar. 31, 1964).
- (i) An action by the registered owner of land (protected by a Torrens Title) to recover possession of said land. (*Act 496*).
- (j) Case of Rodil

Rodil v. Benedicto
L-28616, Jan. 22, 1980

The right of the applicant for registered land (or the purchaser thereof) to ask for the writ of possession does not prescribe.

Art. 1144. The following actions must be brought within ten years from the time the right of action accrues:

- (1) Upon a written contract;**
- (2) Upon an obligation created by law;**
- (3) Upon a judgment.**

COMMENT:**(1) Actions That Prescribe in 10 Years**

The Article enumerates three kinds.

Other actions that prescribe in 10 years include the following:

- (a) action to recover *de jure* possession of real property from a possessor in good faith. (*Art. 555, Civil Code; also Art. 1141, par. 2, in relation to Art. 1134, Civil Code*).
- (b) a real mortgage action. (*Art. 1142, Civil Code*).

[*NOTE: An action to annul a marriage on the ground of impotency prescribes in eight (8) years, counted from the celebration of the marriage. (Art. 87, par. 6, Civil Code).*]

**Veloso v. Workmen's Compensation Commission
78 SCRA 503**

The liability of an employer for compensation cases under the Workmen's Compensation Law prescribes in ten (10) years.

**Negre v. Workmen's Compensation Commission
GR 43795, Apr. 15, 1985**

A workmen's compensation claim filed 8 years after the employee's death is well within the statutory period to file a compensation claim, which is 10 years.

**Villamor v. CA
GR 97332, Oct. 10, 1991**

Under Article 1144(1) of the Civil Code, actions upon a written contract must be brought within ten (10) years. The deed of option was executed on Nov. 11, 1971. The acceptance was also made in the same instrument. The complaint was filed by Villamor on Jul. 13, 1987, 17 years from the time of the execution of the contract. Hence, the right of action had prescribed. There were allegations by Villamor that they demanded from Reyes as early as 1984 the enforcement of their rights under the

contract. Still, it was beyond the ten (10)-year period prescribed by the Civil Code.

It is of judicial notice that the price of real estate in Metro Manila is continuously on the rise. To allow Villamor to demand the delivery of the property subject of this case 13 years or 17 years after the execution of the deed at the price of only P70 per square meter is inequitous. For reasons of equity and in consideration of the fact that Reyes has no other decent place to live in, the Court in the exercise of equity jurisdiction, is not inclined to grant Villamor's prayer.

(2) Example of a Written Contract

A passenger of a ship, or his heirs, can bring an action based on *culpa contractual* within a period of 10 years because the TICKET issued for the transportation is by itself a COMPLETE WRITTEN CONTRACT. (*Peralta de Guerrero, et al. v. Madrigal Shipping Co., L-12951, Nov. 17, 1959*).

[NOTE: An action for the reformation of a written contract prescribes in ten (10) years. (*Jayme v. Judge Nestor Alampay, L-39592, Jan. 28, 1975*).]

(NOTE: In this case, the Court held that “although the complaint does not state that the transportation was undertaken by virtue of a written contract of carriage, nevertheless this can be *implied* from the *complaint* because it is a matter of common knowledge that whenever a passenger boards a ship for transportation from one place to another, he is issued a ticket wherein the terms of the contract are specified.”)

(3) Examples of Obligations Created by Law

- (a) The obligation to pay indemnity for a legal right of way. (If the right of way of a public road was acquired in 1914, the claim for payment of the same brought to the Auditor-General only in 1955 has prescribed, especially where, due to the loss of the papers during the war, the Government cannot be sure that no payment has been made). (*Rosario v. Auditor-General, L-11817, Apr. 30, 1958*).
- (b) An action to recover compensation for the death of a worker or employee, being an action based on law, prescribes in

10 years, in the absence of any specific provision of law on the matter. (Under the former law, Act 190, said action prescribed after 6 years). (*Pan Phil. Corp. v. Workmen's Compensation Com. and Frias*, L-9807, Apr. 17, 1957). [NOTE: In the *Pan Phil. Corporation case*, the death occurred on Dec. 25, 1945. The claim was filed with the Workmen's Compensation Division of the Bureau of Labor on Feb. 11, 1949. The Bureau then ordered the employer to pay compensation on September 9, 1950, but on Jun. 20, 1952, the Workmen's Compensation Commission was created and it took cognizance of the case. On Feb. 3, 1955, decision was rendered on the claim which was subsequently affirmed by the Commissioner, but the employer raised the defense of prescription, on the ground that when the Commission assumed jurisdiction over the case on Jun. 20, 1952, the six years' prescription period provided for in Act 190 had already expired. The Supreme Court affirmed the ruling of the Commission that the period of prescription had been extended by Art. 1144(2) of the Civil Code to 10 years from the accrual of the action and that the 10-year period did not expire until Dec. 25, 1965. On the claim that Art. 1144 could not be applied because Art. 2252 of the Code provides that changes made and new provisions and rules laid down by this Code which may prejudice or impair vested or acquired rights in accordance with the old legislation shall have "no retroactive effect" and that the application of Art. 1144 would impair vested rights of the employer, the Court held that the employer had *no* vested right when the period of 6 years provided in Act 190 did not expire until Dec. 15, 1951.]

(4) Actions Based on a Judgment

The judgment referred to here must be a final and executory one (that is, on appeal, the judgment was confirmed, or that no appeal was ever made within the proper period). Parenthetically, the validity of a judgment or order of a court which has become final and executory, may be attacked generally only by a direct action, or proceeding to annul the same. (*See Rosensons, Inc., et al. v. Hon. Jose Jimenez, et al.*, L-41225, Nov. 11, 1975).

Installments for support granted by a final judgment prescribe after 10 years, each particular installment prescribing after 10 years from the time it is due. (*Trinidad Florendo v. Rufino Organo*, L-4037, Nov. 29, 1951).

[NOTE: Under the Rules of Court, a judgment becomes DORMANT after 5 years. This means that the judgment may be enforced only within 5 years by writ of *execution*. Thereafter, since the judgment has become *dormant*, it can be enforced only by another *action*, within 10 years from the time there was final judgment on the first action. (See Sec. 6, Rule 39, Revised Rules of Court). It necessarily follows that the action to enforce the judgment must be *filed* within 10 years. The time, however, that a moratorium law affecting the obligation was in force should be deducted from the 10-year prescriptive period for the reason that moratorium laws have the effect of tolling (suspending) the prescriptive period. (*PNB v. Aboitiz and Pascual*, L-9500, Apr. 11, 1957; *Tioseco v. Day*, L-9944, Apr. 30, 1957; *Liboro, et al. v. Finance and Mining Investment Corp.*, L-8948, Nov. 29, 1957; *Intestate Estate of Montilla, Jr. v. Pacific Co.*, L-8223, Dec. 20, 1955; and *Manila Motor Co., Inc. v. Flores*, L-9396, Aug. 16, 1956).]

In *Quimabao v. Mora* (L-12690, May 25, 1960), a driver was convicted in a criminal case on May 19, 1950, and was sentenced among other things, to indemnify the offended party in the amount of P2,000. However, said driver was insolvent. *Issue*: What is the prescriptive period for suing the driver's employer for his subsidiary liability? *HELD*: Ten years, for the suit is based, not on the driver's negligence, but on the final judgment in the criminal case.

In *Heirs of Sindiong v. Committee*, L-15975, April 30, 1964, it was held that an action to enforce a decision (or to revive a court judgment) prescribes upon the expiration of *ten years* from the date the decision became final.

Olego v. Rebuena
L-39350, Oct. 29, 1975

FACTS: More than 10 years after a judicial compromise had been approved, plaintiff sought to cite defendant in contempt

of court for having allegedly violated the judgment. *Issue:* May this be done?

HELD: No, this will not be allowed, for in effect what plaintiff wanted was to enforce a judgment that had prescribed (10 years had passed) thru the institution of contempt proceedings.

(5) Action Not Actually Based on Written Contract

Bucton, et al. v. Gabar, et al. L-36359, Jan. 31, 1974

FACTS: Villarin sold in 1946 to Gabar a parcel of land on the installment plan. Gabar in turn had an oral agreement with Bucton that the latter would pay half of the price, and thus own half of the land. Bucton paid her share to Gabar, and was given in 1946 receipts acknowledging the payment.

In 1947, Villarin executed a formal deed of sale in favor of Gabar, who immediately built a house on half of the lot. Bucton took possession of the other half, and built improvements thereon. When Bucton asked for a separate title, she was refused, and so, in 1968, she filed a complaint to compel Gabar to execute a formal deed of sale in her favor. The Court of Appeals ruled that the action had already prescribed because this was an action to enforce a written contract, and should have been brought within 10 years from 1946, under Art. 1144 of the Civil Code. *Issue:* Has the action really prescribed?

HELD: No, the action has not really prescribed. The error of the Court of Appeals is that it considered the execution of the receipt (in 1946) as the basis of the action. The real basis of the action is Bucton's *ownership* (and possession of the property). No enforcement of the contract of sale is needed, because the property has already been delivered to Bucton, and ownership thereof has already been transferred by operation of law under Art. 1434, referring to property sold by a person (Gabar) who subsequently becomes the owner thereof. The action here therefore is one *to quiet title*, and as Bucton is in possession, the action is imprescriptible.

(6) Payment of Life Insurance

**Philippine American life & General Insurance Co.
v. Judge Lore R. Valencia-Bagalacsa,
RTC of Libmanan, Camarines Sur, Br. 56, etc.,
GR 139776, Aug. 1, 2002.**

FACTS: On June 20, 1995, private respondents, as legitimate children and forced heirs of their late father, Faustino Lumaniug, filed with the RTC of Libmanan, Camarines Sur docketed as Civil Case L-787, a complaint for recovery of sum of money against petitioner alleging that: (1) their father was insured by petitioner under Life Insurance Policy 1305486 with a face value of P50,000; (2) their father died of “coronary thrombosis” on Nov. 25, 1980; (3) on Jun. 22, 1981, they claimed and continuously claimed all the proceeds and interests under the life insurance policy in the amount of P641,000; and (4) despite repeated demands for payment and/or settlement of the claim due from petitioner, the last of which was on Dec. 1, 1994, petitioner finally refused or disallowed said claim on Feb. 14, 1995. In view thereof, private respondents filed their complaint on Jun. 20, 1995.

Petitioner filed an Answer with Counterclaim and Motion to Dismiss, contending that:

1. the cause of action of private respondents had prescribed and they are guilty of laches;
2. it had denied private respondents’ claim in a letter dated Mar. 12, 1982 on the ground of concealment on the part of the deceased insured Faustino when he asserted in his application for insurance coverage that he had not been treated for indication of “chest pain, palpitation, high blood pressure, rheumatic fever, heart murmur, heart attack or other disorder of the heart or blood vessel” when, in fact, he was a known hypertensive since 1974;
3. private respondents sent a letter dated May 25, 1983 requesting for reconsideration of the denial; and
4. in a letter dated July 11, 1983, it reiterated its decision to deny the claim for payment of the proceeds more than 10 years later, or on Dec. 1, 1994, it received a letter from Jose

C. Claro, a provincial board member of Camarines Sur, reiterating the early request for reconsideration which it denied in a letter dated Feb. 14, 1995.

Private respondents opposed the motion to dismiss. On Jun. 7, 1996 the RTC issued an Order which reads, in part: "After a perusal of the motion to dismiss by defendants' counsel and the objection submitted by plaintiff's counsel, the court finds that the matters treated in their respective pleadings are evidentiary in nature, hence, the necessity of a trial on the merits." Petitioner's motions for reconsideration was denied by the RTC in its Order dated Dec. 12, 1997 upholding, however, in the same Order the claim of private respondents' counsel that the running of the 10-year period was "stopped" on May 25, 1983 when private respondents requested for a reconsideration of the denial, and it was only on Feb. 14, 1995 when petitioner finally decided to deny their claim that the 10-year period began to run. Petitioner filed a petition for *certiorari* in the Court of Appeals (CA). On Apr. 30, 1999, the CA rendered its decision finding no grave abuse of discretion committed by the court *a quo* when it issued the Orders dated Jun. 7, 1996 and dated Dec. 12, 1997, respectively. Hence, the present petition for review.

ISSUE: Whether or not the complaint filed by private respondents for payment of life insurance is already barred by prescription of action.

HELD: The RTC's ruling that the cause of action of private respondents had not prescribed, is arbitrary and patently erroneous for not being founded on evidence on record, and, therefore, the same is void. Consequently, while the CA did not err in upholding the Jun. 7, 1996 Order of the RTC, it committed a reversible error when it declared that the RTC did not commit any grave abuse of discretion in issuing the Order dated Dec. 12, 1997. The CA should have granted the petition for *certiorari* assailing said Order of Dec. 12, 1997. Said Order was issued with grave abuse of discretion for being patently erroneous and arbitrary, thus, depriving petitioner of due process.

The petition is partly granted. The assailed CA decision dated Apr. 30, 1999 insofar only as it upheld the Order dated Dec. 12, 1997 is reversed and set aside. A new judgment is entered reversing and setting aside the Order dated Dec. 12, 1997

of the RTC of Libmanan, Camarines Sur, Br. 56, and affirming its Order dated Jun. 20, 1995. Said RTC is directed to proceed with dispatch with Civil Case L-787.

Art. 1145. The following actions must be commenced within six years:

- (1) Upon an oral contract;
- (2) Upon a quasi-contract.

COMMENT:

(1) Actions That Prescribe in 6 Years

The Article enumerates two kinds.

(2) Examples

- (a) In *Ilagan v. Adame*, L-19619, Mar. 31, 1964, it was held that an action to enforce an *oral* contract of tenancy (action to compel the landlord to reinstate the tenant to the land) comes under Art. 1145 (six years) and *not* under Art. 1149 (five years) of the Civil Code.
- (b) In *Belman Compania, Inc. v. Central Bank*, L-15044, Jul. 14, 1960, it was held that an action to recover a foreign exchange tax *erroneously* collected by the Central Bank (*Bangko Sentral*) is one based on the quasi-contract of *solutio indebiti*, and it, therefore, prescribes in *six years*.

(3) Actions Where Periods Are Not Fixed

Any other action whose period has not been fixed in the Civil Code or in other laws, to be counted from the time the right of action accrues. (*Art. 1149, Civil Code*).

Art. 1146. The following actions must be instituted within four years:

- (1) Upon an injury to the rights of the plaintiff;
- (2) Upon a quasi-delict.

COMMENT:**(1) Actions That Prescribe in 4 Years**

The Article enumerates two kinds.

Other actions include:

- (a) Action for the annulment of marriage based on non-age, fraud, force, or intimidation. (*Art. 87, pars. 1, 4, and 5, Civil Code*).
- (b) Action for the *revocation* or *reduction* (this is actually only for *reduction*) of donations based on birth, appearance, or adoption of a child. (*Art. 763, Civil Code*).
- (c) Action to revoke a donation for non-compliance with conditions imposed by donor upon donee, the period to be counted from the non-compliance with the said condition. (*Art. 764, Civil Code*).
- (d) Action for *rescission* of contracts. (*Art. 1389, par. 1, Civil Code*).

[*NOTE: In case of persons under guardianship and in the case of absentees, the period of prescription shall not begin until the termination of the former's incapacity, or until the domicile of the latter is known. (Art. 1389, par. 2, Civil Code).*]

- (e) Action for the annulment of a contract. (*Art. 1391, par. 1, Civil Code*).

[*NOTE: In cases of intimidation, violence, or undue influence, the period is counted from the time the vitiation ceases (Art. 1391, par. 3, Civil Code); in case of mistake or fraud, from the time of discovery of the same (Art. 1391, par. 4, Civil Code); and in cases of contracts entered into by minors or other incapacitated persons, from the time the guardianship ceases. (Art. 1391, par. 5, Civil Code).*]

(2) Example of "Injury to the Rights of the Plaintiff"

In *Valencia v. Cebu Portland Cement Co., et al.*, L-13715, Dec. 23, 1959, a case involving a plaintiff separated from his employment for alleged unjustifiable causes, the Supreme Court

held that the action is one for “injury to the rights of the plaintiff, and must be brought within 4 years.”

(3) Rules for Quasi-Delicts

- (a) In a quasi-delict, the period begins from the day the quasi-delict was committed.

Paulan, et al. v. Sarabia, et al.
L-10542, Jul. 31, 1958

FACTS: Basco was riding on a bus owned by defendant Sarabia when it collided with another truck owned by third-party defendant Lim. Basco died on Jul. 25, 1951. On Apr. 19, 1955, a complaint against Sarabia and his driver was filed by the widow and heirs. On Jul. 11, 1955 (after more than 4 years from the date of the collision), Sarabia in turn filed a third-party complaint against Lim and her driver. *Issue:* From what time must the 4-year period be counted for the filing of the third-party complaint — from the day of the collision or from the filing of the principal complaint?

HELD: The period begins from the day of the collision, since the action is based on a *quasi-delict*. The third-party complaint was therefore dismissed.

- (b) An action for damages arising from physical injuries because of a tort must be filed within 4 years. (*See Escueta v. Fandialan, L-39675, Nov. 29, 1974*). However, when a criminal action for the same physical injuries is instituted, the civil action for recovery of civil liability arising from the offense charged is impliedly instituted with the criminal action, unless the offended party expressly waives the civil action or reserves his right to institute it separately.

Degollacion v. Li Chui
L-11640, May 22, 1956

FACTS: A traffic accident occurred on Sept. 29, 1949. A criminal case was brought against the defendant’s driver in the Justice of the Peace Court (now Municipal/Metropolitan Trial Court) on Dec. 13, 1949. The case was, however,

eventually dismissed, without prejudice, by the Court of First Instance, on Feb. 16, 1954. Having failed to have the criminal case reinstated thru the fiscal's office, the plaintiff filed a civil action for damages against the defendant's employer.

HELD: The civil action did not prescribe, it appearing that the plaintiff neither expressly waived the civil action *nor* reserved his right to file a separate civil action. Because the civil aspect remained with the criminal case, the period of prescription was suspended from Dec. 13, 1949 up to Feb. 16, 1954 (the period when the criminal case *was pending*).

[*NOTE:* The ruling stated above is correct if the civil action is based on the CRIME. If the civil action is based on a QUASI-DELICT (which is considered an *independent* civil action), the institution of the criminal action *cannot* have the effect of interrupting the civil action based on such quasi-delict. (*Paulan, et al. v. Sarabia, et al., L-10542, Jul. 31, 1958*).]

(4) Rule Under the Code of Civil Procedure

Under the Code of Civil Procedure, an action to recover personal property, and an action for the recovery of damages for taking, retaining, or injuring personal property, can only be brought within 4 years after the right of action accrues.

Lapuz v. Sy Uy L-10079, May 17, 1957

FACTS: In a civil case between the defendant and his wife, certain jewelries belonging to the plaintiff were alleged to have been wrongfully attached on Aug. 24, 1943. Unfortunately, *during* the liberation, the jewels were looted from the safe of the sheriff. On Apr. 27, 1952, the plaintiff filed an action for the recovery of the jewelries or of their value. *Issue:* Has the action already prescribed?

HELD: The action has prescribed. Whether the case is considered as one for the recovery of personal property or one for damages based on a *tort*, the plaintiff had only four years

from Aug. 24, 1943 or up to Aug. 24, 1947, within which to file the action against Sy Uy.

Art. 1147. The following actions must be filed within one year:

- (1) For forcible entry and detainer;**
- (2) For defamation.**

COMMENT:

(1) Actions That Prescribe in 1 Year

The Article enumerates two kinds. Others include:

- (a) An action for legal separation, to be counted from knowledge of the cause (but the action must be brought within 5 years from occurrence). (*Art. 102, Civil Code*).

Note: Under Art. 57 of the Family Code, the prescriptive period for filing an action for legal separation shall be counted from the date of occurrence of the cause.

- (b) Action to *impugn* the *legitimacy* of a child, the period to be counted from the *recording* of the birth in the Local Civil Registry, if the husband should be in the *same* place, or in a proper case, any of his heirs. (*Art. 263, par. 1, Civil Code*).

[*NOTE:* If the husband or his heirs are absent, the period shall be 18 months if they should reside in the Philippines; 2 years if abroad; if the birth of the child is concealed, the period is to be counted from the discovery of the fraud. (*Art. 263, par. 2, Civil Code*).]

- (c) Action for the revocation of a donation on the ground of *ingratitude*, the period to be counted from the time the donor had knowledge of the fact, and it was possible for him to bring the action. (*Art. 169, Civil Code*).
- (d) Action for *rescission* or for *damages* for sale of immovable encumbered with any non-apparent burden or servitude, the period to be counted from the execution of the deed. (*Art. 1560, par. 3, Civil Code*).

- (e) Action for *damages* (no rescission anymore) for sale of immovable encumbered with any non-apparent burden or servitude, the one year after the execution of the deed having lapsed, said period to be counted from the date on which the burden or servitude is discovered. (*Art. 1560, par. 4, Civil Code*).

(2) Rule in Case of Forcible Entry and Detainer

In *forcible entry*, the period is counted from date of unlawful deprivation (*Sec. 1, Rule 70, 1997 Rules of Civil Procedure*); in case of fraud or stealth, counted from discovery of the same. In *unlawful detainer*, the period is to be counted from the date of *last demand*. (*Sarona, et al. v. Villegas, L-22984, Mar. 2, 1968; DBP v. Canonoy, L-29422, Sept. 30, 1970; and Calipayan v. Pascual, L-22645, Sep. 18, 1967*).

(3) Rule in Case of Libel

In libel, while it is true that the written defamation become actionable upon its publication (*i.e.*, communication to third person), still the libelous matter must first be exhibited to the person libelled before the action can be brought. Hence, the one-year period runs from the time the offended party knows of the libelous matter. A person defamed can hardly be expected to institute proceedings for damages arising from libel when he has no knowledge of the said libel. (*Alcantara, et al. v. Amoranto, L-12493, Feb. 29, 1960*).

(4) Actions That Prescribe in Six (6) Months

- (a) Action for the *reduction* of the price or for *rescission* of a sale of real estate (by the unit area) if the vendor is unable to deliver on demand all that is stated in the contract. (*Art. 1543, in re Art. 1539, Civil Code*).
- (b) Action for *reduction* of the price or for *rescission* of a sale (*a cuerpo cierto*) of real estate (made with mention of boundaries) if the vendor is unable to deliver all that is included within said boundaries. (*Art. 1543, in re Art. 1542, Civil Code*).

Art. 1148. The limitations of action mentioned in Articles 1140 to 1142, and 1144 to 1147 are without prejudice to those specified in other parts of this Code, in the Code of Commerce, and in special laws.

COMMENT:

(1) Periods of Prescription Specified Elsewhere

Aside from the periods and actions indicated in the Articles stated, other periods and other actions are found elsewhere.

**Basa v. Republic
GR 45277, Aug. 5, 1985**

The 5-year period after assessment within which court action for tax collection shall be instituted is suspended during the period the Bureau of Internal Revenue is prohibited from instituting court action.

**Republic v. Ricarte
GR 46893, Nov. 12, 1985**

The prescriptive period provided for in the Tax Code is counted from the date when the BIR assessed the income tax return of the taxpayer. The action has prescribed if it had been filed 6 years and 9 months after the assessment. If the Government presents no evidence that the taxpayer received a copy of a subsequent or follow-up assessment notice regarding the alleged deficiency tax within the 5-year period, then, the prescriptive period is deemed to have lapsed.

**Baliwag Transit, Inc. v. CA
GR 57493, Jan. 7, 1987**

An action upon an obligation created by law, such as a petition filed by an employee to compel the employer to remit his SSS contributions to the SSS prescribes after 10 years from the time the right of action accrues.

(2) Rules in Case of Fraud

- (a) The action for relief on the ground of fraud may be brought within 4 years from the discovery of the fraud. (*Art. 1391, Civil Code; and Sec. 43[3], Act 190*). Thus, where the plaintiffs filed an action in 1953 to annul a contract of sale on the ground that they had been fraudulently induced to sign the same in the belief that it was a mortgage, although they discovered the fraud in 1945, the same is barred. (*Raymundo v. Afable, L-7651, Feb. 28, 1955*). A subsequent action by the same plaintiffs against the same defendants for the recovery of title and possession of the real property, subject matter of the aforementioned contract of sale is likewise barred. While it may be true that the recovery of the title and possession of the lot were ultimate objectives of the plaintiffs, still to attain that goal, they must first travel over the road of relief on the ground of fraud. (*Rone v. Claro and Baquiring, 91 Phil. 250*). Indeed, the plaintiffs *cannot* be declared as still the owners of the property, entitled to its possession, *without* annulling the contract of sale. Said contract cannot be annulled without declaring it fraudulent, and annulment on this ground cannot be done anymore in view of the prescription. (*Raymundo v. De Guzman, L-109020, Dec. 29, 1959*).
- (b) An action for reconveyance of land, for which a patent had been issued to the defendant by reason of fraudulent statements, is one based on fraud, and must be instituted within 4 years from the discovery of the fraudulent statements made in the application. (*Rosario v. Aud. Gen., L-11817, April 30, 1958; Jean v. Agregado, L-7921, Sept. 28, 1955*).

Art. 1149. All other actions whose periods are not fixed in this Code or in other laws must be brought within five years from the time the right of action accrues.

COMMENT:**(1) General *Proviso* — 5 years**

The Article explains itself.

Tolentino v. CA and David
L-41427, Jun. 10, 1988

All actions, unless an exception is provided, have a prescriptive period. Unless the law makes an action imprescriptible, it is subject to bar by prescription and the period of prescription is 5 years from the time the right of action accrues when no other period is prescribed by law. The Civil Code provides for some rights which are not extinguished by prescription, but an action against a woman who has been legally divorced from her husband, brought by the latter's present wife, seeking to enjoin the former wife from using the surname of her former husband, is not one of them. Neither is there a special law providing for imprescriptibility.

The mere fact that the supposed violation of the petitioner's right may be a continuous one does not change the principle that the moment the breach of right or duty occurs, the right of action accrues and the action from that moment can be legally instituted. It is the legal possibility of bringing the action which determines the starting point for the computation of the period of prescription. The petitioner should have brought legal action immediately against the private respondent after she gained knowledge of the use by the private respondent of the surname of her former husband.

(2) Examples

- (a) Action to impugn the recognition of a natural child. (*Art. 296, Civil Code*).
- (b) Action to impugn the legitimation of a child. (*Art. 275, Civil Code*).
- (c) Action to reduce inofficious donations (to be counted from the death of the donor). (*See Art. 772, Civil Code*).

[NOTE: Castan believes, however, that the period for this is 4 years, *not 5 years*, applying the rule for *rescissible* contracts under Art. 1389 of the Civil Code. (4 *Castan 194*).]

(3) Query (Re Validity of Stipulation Concerning Period)

May the parties stipulate when action for court enforcement may be brought?

ANS.: Yes, unless the stipulation:

- (a) contravenes a valid statute;
- (b) or the time fixed is unreasonably short.

[Thus, the Supreme Court, in *Pao v. Remorosa* (L-10292, Feb. 28, 1958) held that an agreement whereby the claim against the surety must be filed within thirty days, otherwise, court action is waived, is unreasonable and is an invalid limitation of action. (See *Ongsiako v. World Wide Insurance Co.*, L-12077, June 27, 1958).]

Art. 1150. The time for prescription for all kinds of actions, when there is no special provision which ordains otherwise, shall be counted from the day they may be brought.

COMMENT:

(1) From What Time Period Is to Be Counted

Note that the period shall be counted from *the day the action may be brought*, except if there is a special provision that ordains otherwise.

(2) Reason for the Law

One cannot be said to begin sleeping on his rights, if such rights have not yet accrued. Thus, the starting point is the *legal possibility*. (*TS*, May 8, 1903).

(3) Examples

- (a) In an action based on a *quasi-delict* because of a traffic collision — from the day of the collision. (*Paulan, et al. v. Sarabia, et al.*, L-10542, Jul. 3, 1958).
- (b) In a promissory note with a maturity date, from the date of such maturity. (See *Varela v. Marajas, et al.*, L-10215, Apr. 30, 1958).
- (c) In a collection for the unpaid balance of subscribed corporation shares, from the date of demand or call by the Board of Directors. (*Garcia v. Suarez*, 67 Phil. 441).

- (d) In an action to compel the registration of an assigned membership certificate in a non-stock corporation, the period runs *not* from the date of assignment, but from the date of *denial* of registration. *Reason:* The *existence* of a right is one thing; right to have is another. It was only from the time of *denial* of registration that the cause of action accrued. (*Lee E. Won v. Wack Wack Golf and Country Club, L-10122, Aug. 30, 1958*).
- (e) In an action to recover payment of the difference between the wages paid an employee and that fixed by the Minimum Wage Law, *every* monthly payment of salaries made by defendant employer gives the employee a *separate and independent* cause of action to recover the underpayment; hence, the period provided for by law is to be counted from the date of each and every monthly payment. (*Abrasaldo, et al. v. Compania Maritima, L-11918, Jul. 31, 1958*).

(4) Some Cases

Lichauco v. Soriano **35 Phil. 203**

FACTS: A promise to pay within one year was made. At the option of the creditor, the period could be extended for one year. The debtor failed to pay, and the creditor failed to demand.
Issue: From what time will the prescriptive period run?

HELD: Mere delay by the debtors and failure to demand by the creditor does not mean that the extension of one year had been granted. Therefore, since the debt became due at the end of the original year, the prescriptive period should commence from said end of the first year.

Varela v. Marajas, et al. **L-19215, Apr. 30, 1958**

FACTS: The heirs of a deceased person settled the estate in a written agreement dated Feb. 14, 1941, providing that one of them would pay an *absent* heir, upon the reappearance of the latter. Said absent heir returned to the Philippines from the United States in November, 1945. He immediately asked

for his share, but was *not* paid. He then filed the complaint for payment of his share on Dec. 6, 1954. *Issue*: From what time should the prescriptive period be counted?

HELD: The prescriptive period should be counted from November, 1945, when he presented himself for payment but was not paid. Hence, the action has not yet prescribed. It is unfair to begin computing from 1941 when the agreement was made. This is so, because the agreement provided for payment upon his appearance, and no period was fixed for said purposes. The situation is similar to that of a debt evidenced by a written document payable within a stated period, where the cause of action would accrue only upon the expiration of the stipulated period in case payment is not made — certainly, not from the date of the agreement.

**Intestate Estate of Francisco Ubat, et al. v.
Atanasia Ubat de Montes, PNB, et al.
L-11633, Jan. 31, 1961**

FACTS: Eduardo Ubat borrowed P460 from the Philippine National Bank in 1936, payable “on or before the 7th day of October, 1946.” The contract further provided that the payment “*shall* be made” in 10 equal yearly installments. Suit for the whole amount was brought in 1954 since not a single installment had been paid. *Issue*: Has the debt prescribed?

HELD: Under Art. 1150 of the new Civil Code, the prescriptive period starts from the time creditor may file an action, *not* from the time he wishes to do so. The payment of yearly installments was mandatory because of the phrase “*shall* be made.” Therefore, the prescriptive period for EACH installment should start from the time it became due. However, considering the *suspensive effect* of the Moratorium Law, only the first five installments have prescribed. The others may still be recovered.

**Castrillo v. Court
L-18046, Mar. 31, 1964**

The prescriptive period within which to ask for a declaration of co-ownership in a parcel of land covered by a Torrens

Title begins from the moment a transfer certificate is issued in the name of the *new owners*.

Republic v. Hon. Numeriano Estenzo
L-24656, Sept. 25, 1968

ISSUE: To have a judgment on compromise set aside, from what moment should prescription be counted?

HELD: By its very nature, a judgment based on compromise is generally final and immediately executory. (*Enrique v. Padilla*, 77 Phil. 373; *Badiongan v. Ceniza, et al.*, 102 Phil. 750). For this reason, prescription begins (or tolls) *not* from the date of its entry, but from the date of its rendition. (*Dirige v. Biranya*, L-22033, Jul. 30, 1966).

Art. 1151. The time for the prescription of actions which have for their object the enforcement of obligations to pay principal with interest or annuity runs from the last payment of the annuity or of the interest.

COMMENT:

Obligations to Pay Principal With Interest or Annuity

Example: If a matured debt is recognized later by the payment of interest, the prescriptive period begins, not from the date of maturity, but from the last payment of said interest. (*See Obras Pias v. Devera Ignacio*, 17 Phil. 45).

Art. 1152. The period for prescription of actions to demand the fulfillment of obligations declared by a judgment commences from the time the judgment became final.

COMMENT:

Obligations Declared by a Judgment

The Article explains itself.

Luzon Surety Co. v. IAC
GR 72645, Jun. 30, 1987

It is now settled that the ten-year period within which an action for revival of a judgment should be brought, commences to run from the date of finality of the judgment, and not from the expiration of the five-year period within which the judgment may be enforced by mere motion.

Three (3) reasons were advanced, to wit:

(1) Sec. 447 of the Code of Civil Procedure (which is similar to the last sentence of Sec. 6, Rule 39 of the Revised Rules of Court) should be construed in relation to Sec. 43, No. 1 of the said Code (which is similar to Art. 1144 of the Civil Code); and as thus construed, the conclusion one arrives at is that after the expiration of the five years within which execution can be issued upon a judgment, the winning party can revive it only in the manner therein provided so long as the period of ten years does not expire from the date of said judgment, according to Sec. 43, No. 1 of the same Code.

(2) The right of the winning party to enforce the judgment against the defeated party “begins to exist the moment the judgment is final; and this right, according to our Code of Civil Procedure, consists in having an execution of the judgment issued during the first five years next following, and in commencing after that period the proceeding provided in Sec. 447 to revive it, and this latter remedy can be pursued only before the judgment prescribes, that is to say, during the five years next following. It is so much an action to ask for an execution as it is to file a complaint for reviving it, because, as we know, by action is meant the legal demand of the right or rights one may have.”

(3) If it is held that the winning party has still ten (10) years within which to revive the judgment after the expiration of five years, then the judgment would not prescribe until after fifteen (15) years, which is against No. 1 of Sec. 43 of the Code of Civil Procedure. It cannot be said that such is the letter, and much less, the intention of the law, for there is nothing in Sec. 447 of the said Code, making this new period different from the one prescribed in said Sec. 43, No. 1, or reconciling these two

provisions, there being no other way of reconciling them than to say that after the expiration of the first five years next following the judgment, there remains to the victorious party only another five years to review it.

Art. 1153. The period for prescription of action to demand accounting runs from the day the persons who should render the same cease in their functions.

The period for the action arising from the result of the accounting runs from the date when said result was recognized by agreement of the interested parties.

COMMENT:

(1) Actions to Demand Accounting and Actions Arising from Result of the Accounting

The first paragraph deals with the *demand for accounting*, the second deals with the *result of the accounting*.

(2) Accounting and Reliquidation

There is NO difference, however, between an action for ACCOUNTING and one for RELIQUIDATION, both of which involve the determination and settlement of what is due the parties under the provisions of the law. (*Mateo v. Duran*, L-14314, Feb. 22, 1961 and *Yusay v. Alejado*, L-14881 and L-15001-7, Apr. 30, 1960).

Art. 1154. The period during which the obligee was prevented by a fortuitous event from enforcing his right is not reckoned against him.

COMMENT:

Effect of a Fortuitous Event

The Article explains itself. After all, fortuitous events are generally exempt.

Art. 1155. The prescription of actions is interrupted when they are filed before the court, when there is a written extrajudicial demand by the creditors, and when there is any written acknowledgment of the debt by the debtor.

COMMENT:

(1) Old Law Re Interruption of Prescriptive Periods

Under the old law, while it is true that the prescription of actions is interrupted when they are filed before the court, still, if the case is dismissed without any unfavorable judgment against the defendants, even if without prejudice to another action, the same does *not* constitute an interruption of the period of prescription for the parties are in exactly the same position. (*Ongsiako v. Ongsiako*, L-7510, Mar. 30, 1957). This doctrine was reiterated in *Amar v. Odianan*, L-15179, Sept. 30, 1960. Moreover, according to the Court, Act 190 contains NO provisions on the interruption or suspension of the period of prescription by the mere institution of an action.

(2) When Prescription of Actions Is Interrupted Under the Civil Code

- (a) *filed* before the court (judicial demand) (this is true even if there were *no summons* issued and even if there be no judgment). (*Manresa*). (NOTE that this Article must not be confused with Art. 1124). Said latter Article does *not* apply here in Art. 1155. [NOTE: If a complaint is *amended*, with the impleading of an *additional* defendant, prescription is interrupted as to such additional defendant only *from the time of the admission of the amended complaint*, not from the filing of the original complaint. (*Aetna Insurance v. Barber Steamship Lines, Inc.*, L-25266, Jan. 15, 1975).]
- (b) *written* extrajudicial demand.
- (c) *written* acknowledgment by the debtor of his debt.

(3) Requirement of Written Demand or Acknowledgment

Note the requirement of a WRITTEN extrajudicial demand or acknowledgment. Thus, a written offer of payment works as a renewal of the obligation and prevents prescription from

setting in. (*Phil. National Bank v. Hipolito*, L-16463, Jan. 30, 1965). Thus also, an *oral* or *verbal* acknowledgment has been held insufficient to interrupt or suspend the running of the prescriptive period. Like the Statute of Frauds, the plain purpose of the law is to avoid uncertainty in the determination of the periods of limitation, and not leave such determination on the fallacies of human memory. This was also the rule under the old rule. (*Sec. 50 of Act 190*).

It would be different, however, if such oral acknowledgment assumes a new obligation, and is not merely a promise to pay an old debt at a future time. (*Borromeo v. Zaballero*, L-14357, Aug. 31, 1960). Written extrajudicial demands made AFTER an action has prescribed do NOT of course revive the action. (*Belman Co., Inc. v. Central Bank*, L-15044, May 30, 1960).

(4) Moratorium Law Suspended Right to Sue

The Moratorium Law suspended the creditor's right to sue, and for purposes of prescription, the time it was in force must be excluded from the computation. (*Magdalena, et al. v. Benedicto*, L-9105, Feb. 28, 1958; *Talens, et al. v. Chuakay & Co.*, GR L-10127, Jun. 30, 1958; *Rio & Co. v. Datu Jolkipli*, GR L-12301, Apr. 13, 1959; *Levy Hermanos v. Perez*, GR L-14487, April 29, 1960). BUT the Moratorium Law does not apply to pre-war debts. (*Nielsen & Co., Inc. v. Lepanto*, L-21661, Dec. 28, 1968).

(5) Effect of President Osmeña's Moratorium Order (Exec. Order 32), and the Moratorium Law (Rep. Act 342), upon the Statute of Limitations for Debts Contracted Before Dec. 31, 1941

- (a) If the debtor was a WAR DAMAGE claimant, the period of prescription was suspended from *Mar. 10, 1945* (*Ex. Order No. 32*) to *May 18, 1953* (when the decision in *Rutter v. Esteban*, 49 O.G. 1807, holding *unconstitutional* the further operation of Rep. Act 342 became operative). [Note that in said *Rutter case*, the Moratorium Law was not declared void *ab initio*; the Court only held that its continued operation and enforcement had already become unreasonable and oppressive. Said law therefore suspended the Statute of

Limitations, and no action for collection could be maintained during the period when it was still in effect. (*Vda. de Quiambao v. Manila Motor Co., Inc.*, L-17384, Jan. 30, 1962).] Whether or not the creditor actually brought his suit *before or after* the *Rutter* decision, the period for the enforcement of the credit was tolled or suspended. (*Ibid.*). The presumption is that the creditor was a war damage claimant. (*Rio y Compania v. Court of Appeals*, L-15666, Jun. 30, 1962).

- (b) If the debtor was NOT a war damage claimant, the period of prescription was suspended from Mar. 10, 1945 (*Ex. Order 32*) to Jul. 26, 1948 [when the Moratorium Law, Rep. Act 342, became effective]. (*Rio & Co. v. Datu Jolkipli*, GR L-12301, Apr. 13, 1959; see *Hongkong & Shanghai Banking Corp. v. Pauli*, L-15713, Mar. 31, 1962).

(6) Closure of Courts During the Japanese Occupation

Judicial notice may be taken of the fact that the regular courts were closed or ceased to function with the overrunning of Luzon by the Japanese forces in Dec. 1941. They did not reopen until Jan. 30, 1942. This interruption in the functions of the courts naturally suspended also the running of the prescriptive period. (*Talens, et al. v. Chuakay and Co.*, GR L-10127, Jun. 30, 1958).

(7) Actions Under the Carriage of Goods by Sea Act

The interruption by a written extrajudicial demand does not apply to actions under the Carriage of Goods by Sea Act, which must be filed within one year from receipt of the cargo. The reason is that matters affecting transportation of goods by sea should be decided in as short a time as possible. To apply the Civil Code provision would permit delays. (*Yek Tong Lin Fire Ins. Co. v. American President Lines, Inc.*, L-11081, Apr. 30, 1958).

Dole Phils., Inc. v. Maritime Co. of the Phils. GR 61352, Feb. 27, 1987

In a case governed by the Carriage of Goods by Sea Act, the general provisions of the Code of Civil Procedure on Prescrip-

tion should not be made to apply. Similarly, in such a case, Art. 1155 cannot be made to apply, as such application would have the effect of extending the one-year period of prescription fixed in the law. It is desirable that matters affecting transportation of goods by sea be decided in as short a time as possible. Thus, the application of Art. 1155 would unnecessarily extend the period and permit delays in the settlement of question affecting transportation, contrary to the clear intent and purpose of the law.

(8) Rule in Taxation Cases

The motion for reconsideration of a decision of the Collector of Internal Revenue *suspends* the running of the prescriptive period within which the taxpayer may appeal to the Court of Tax Appeals; and the period resumes its running the day following the receipt by the taxpayer of the Collector's denial of said motion. (*Collector of Internal Revenue v. Convention of Philippine Baptist Churches*, L-11807, Jan. 28, 1961).

(9) Effect of a Motion for Reconsideration

A motion for reconsideration on the ground that the decision is completely against the evidence and the law, *without pointing out* the finding and pronouncement made in the judgment that were allegedly contrary to the evidence and the law is *pro forma* and does *not* stop the running of the period within which to appeal (*Valdez v. Jugo*, 74 Phil. 49 and *Villalon v. Ysip*, 53 O.G. 1094); and the fact that before entry of the order denying the motion for reconsideration, the movants filed a pleading where they pointed out the fraud allegedly committed, does *not* cure the defect of such motion. (*Garganta, et al. v. Court of Appeals, et al.*, L-12104, Mar. 31, 1959).

(10) Some Cases

Buccat v. Dispo L-44338, Apr. 15, 1988

In order to resolve whether or not the present action has prescribed, it is necessary to first determine when the right of action for the fixing of the period of lease accrued. Should it be

reckoned from the time when the parties entered into the second contract of lease which was on Aug. 1959 as the defendants-appellants claim, or at the time when the decision of the Court of Appeals upholding the validity of the second contract of lease was promulgated which was on Nov. 1972 as the plaintiff-appellee claims?

The Court held that it was only on Nov. 1972 that the cause of action for the fixing of the period of lease accrued. This is as it should be because prior to that, the validity of the second contract of lease was being challenged. The case for unlawful detainer filed by the plaintiff-appellee became in fact a case questioning the validity of the second contract on the grounds that the said contract was simulated and that there was no consideration. The plaintiff-appellee could not have been expected to file an action for the fixing of the period of the lease before the Court of Appeals promulgated its decision because she was not yet aware that the said paragraph of the second contract was a provision that called for an indefinite period. For the reason that the very existence, and subsequently, the interpretation of the second contract of lease, particularly par. 3 thereof, were put in issue in the unlawful detainer case, the court trying the case was required to interpret the provisions of, and consequently, rule on the validity of, the said contract.

PDCP v. IAC
GR 73198, Sept. 2, 1992

As to petitioner's contention that the cause of action of respondent is barred by prescription and that there is a pending case before the Davao RTC with the same cause of action, be it noted that *litis pendentia* cannot apply in an instance where there is *no identity of parties*.

In the case at bar, records show and as admitted by petitioner, the action filed in the Manila RTC was against the respondent while the case filed in the Davao RTC was against DATICOR, the president of which is the respondent. The first case is against a *natural person*, while the second, is against a *juridical person*.

BOOK IV

OBLIGATIONS AND CONTRACTS

TITLE I. — OBLIGATIONS

Chapter 1

GENERAL PROVISIONS

Art. 1156. An obligation is a juridical necessity to give, to do or not to do.

COMMENT:

(1) Elements of an Obligation (derived from the Latin “*obligare*” — to bind)

- (a) an *active* subject (called the obligee or creditor) — the possessor of a right; he in whose favor the obligation is constituted.
- (b) a *passive* subject (called the obligor or debtor) — he who has the duty of giving, doing, or not doing.
- (c) the object or prestation (the subject matter of the obligation).
- (d) the efficient cause (*the vinculum or juridical tie*) — the reason why the obligation exists.

(*NOTE:* In a few cases, FORM — or the manner in which the obligation is manifested — is also important.)

(2) Example

A promises to paint *B*'s picture for *B* as a result of an agreement.

(Here *A* is the obligor; *B* is the obligee; the painting of *B*'s picture is the object or prestation; the agreement or contract is the efficient cause.)

(3) Concept of Prestation (BAR QUESTION)

A *prestation* is an obligation; more specifically, it is the subject matter of an obligation — and may consist of *giving* a thing, *doing* or *not doing* a certain act. The law speaks of an obligation as a *juridical necessity* to comply with a prestation. There is a “juridical necessity,” for non-compliance can result in juridical or legal sanction.

**Mataas na Lupa Tenants’
Association v. Carlos Dimayuga
and Juliana Diego Vda. de Gabriel
L-32049, Jun. 25, 1984**

Under PD 1517, tenants-lessees are given pre-emptive or preferential rights (right of first refusal) if they have occupied the land or lot for over ten (10) years. The owner has this obligation to grant said preference. Thus, he cannot sell to a third person without first offering the same to the lessee. If the latter renounces said right, the waiver must be in a *public instrument*.

(4) Kinds of Obligations

There are various basis for the classification of obligations. Given hereunder are few of them:

(a) *From the viewpoint of “sanction” —*

- 1) civil obligation (or *perfect* obligation)
- 2) natural obligation
- 3) moral obligation (or *imperfect* obligation)

Definitions —

- a) *civil obligation* — that defined in Art. 1156. The sanction is judicial process. *Example*: A promises to pay *B* his (*A*'s) debt of P1 million.

- b) *natural obligation* — the duty not to recover what has *voluntarily* been paid although payment was no longer required. *Example:* A owes B P1 million. But the debt has already prescribed. If A, knowing that it has prescribed, nevertheless still pays B, he (A) cannot later on get back what he voluntarily paid. The sanction is the *law* of course, but only because conscience had originally motivated the payment.
- c) *moral obligation* — the duty of a Catholic to hear mass on Sundays and holy days of obligation. The sanction here is conscience or morality, or the law of the church.

[NOTE: If a Catholic promises to hear mass for 10 consecutive Sundays in order to receive P1 million this obligation becomes a *civil* one.]

- (b) *From the viewpoint of subject matter* —
 - 1) *real obligation* — the obligation to give
 - 2) *personal obligation* — the obligation to *do* or *not to do*

(Example: the duty to paint a house, or to refrain from committing a nuisance)
- (c) *From the affirmativeness and negativeness of the obligation* —
 - 1) *positive or affirmative obligation* — the obligation to *give* or to *do*
 - 2) *negative obligation* — the obligation not to do (which naturally includes “not to give”)
- (d) *From the viewpoint of persons obliged* —
 - 1) *unilateral* — where only one of the parties is bound

(NOTE: Every obligation has 2 parties; If only one of them is bound, we have a unilateral obligation. Example: A owes B P1 million. A must pay B.)
 - 2) *bilateral* — where *both parties* are bound (*Example: In a contract of sale, the buyer is obliged to pay, while the seller is obliged to deliver.*)

[NOTE: Bilateral obligations may be:

- a) reciprocal
- b) non-reciprocal (where performance by one is non-dependent upon performance by the other).]

(5) Criticism of the Definition by the Code

Art. 1156 defines obligation as “a juridical necessity to give, to do, or not to do.” As will be noticed, this stresses merely the duty of the debtor (the passive element) without emphasizing a corresponding *right* on the part of the creditor (the active element). On this point, Justice J.B.L. Reyes of the Supreme Court has remarked: “This definition, taken from Sanchez Roman is *incomplete*, in that, it views obligations only from the debit side. There is no debt without a credit, and the credit is an *asset* in the patrimony of the creditor just as the debt is a liability of the obligor. Following the defective method of the Spanish Civil Code, the new Code separates *responsibility* from the other element of obligation.” (*Lawyer’s Journal*, Jan. 31, 1951, p. 47). He then quotes with approval the following definition given by *Arias Ramos*:

“An obligation is a juridical relation whereby a person (called the creditor) *may demand* from another (called the debtor) the observance of a determinative conduct (the giving, doing, or not doing), and in case of breach, may demand satisfaction from the assets of the latter.”

[NOTE: This definition is accurate because it views “obligation” from a “total” standpoint (both active and passive viewpoint).]

(6) Some Cases

Pelayo v. Lauron **12 Phil. 453 (BAR)**

FACTS: A wife was about to deliver a child. Her parents-in-law called the doctor. **Issue:** Who should pay the doctor: the husband or the parents?

HELD: The husband should pay, even if he was not the one who called the doctor. It is his duty to support the wife,

and support includes medical attendance. The duty to pay is an obligation to give, and is imposed by the law.

Poss v. Gottlieb
193 N.Y.S. 418

FACTS: There were two partners engaged in buying and reselling land. After they had bought a piece of land, one asked the other to sell the latter's share to him for the price invested by the latter. The first partner, who now completely owned the land, resold it at a *huge profit* to a third person. The second partner would not have sold his share had he known that a big offer had been made by such third person. The first partner alleged that he should not be blamed on the ground that he, after all did not make any false concealment to his partner, that is, he did not tell the latter that nobody wanted the land. *Issue:* May the second partner successfully bring an action for damages against the first partner?

HELD: Yes, because the first partner is liable. He had the duty not only to make any false concealment but also to abstain from all kinds of concealment insofar as the partnership was concerned. This is an obligation *to do* (to relay all pertinent information).

Joaquin P. Nemenzo v. Bernabe Sabillano
L-20977, Sept. 7, 1968

FACTS: A municipal mayor, upon assumption of office, arbitrarily dismissed a corporal (a civil service eligible) in the police force of the municipality, without due investigation. *Issue:* Is the mayor personally liable?

HELD: Yes, because his act of dismissing the corporal without previous administrative investigation and without justifiable cause is clearly an injury to the corporal's rights. The mayor cannot hide under the mantle of his official capacity and pass the liability to the municipality of which he was mayor. There are altogether too many cases of this nature, wherein local elective officials, upon assumption of office, wield their new-found power indiscriminately by replacing employees with their own *protegés*, regardless of the laws and regulations governing the

civil service. Victory at the polls should not be taken as authority for the commission of such illegal acts.

Leonides Pengson v. Court of Appeals
GR L-65622, Jun. 29, 1984

If the owner of certain shares should pledge the same to his creditor, and later said owner sells his shares to a third person, the creditor cannot be compelled to surrender the share certificates to the buyer, and this refusal will not invalidate the sale.

Phil. National Bank v. Court of Appeals
74 SCAD 786
(1996)

A local bank, while acting as local correspondent bank, does not have the right to intercept funds being coursed thru it by its foreign counterpart for transmittal and deposit to the account of an individual with another local bank, and thereafter apply the said funds to certain obligations owed to it by the said individual.

(7) In an Option to Buy, Payment of Purchase Price By Creditor Is Contingent Upon Execution and Delivery of a Deed of Sale By Debtor

Obligations under an option to buy are reciprocal obligations. Performance of one obligation is conditioned on the simultaneous fulfillment of the other obligation. In other words, in an option to buy, payment of purchase price by creditor is contingent upon the execution and delivery of a deed of sale by the debtor. (*Heirs of Luis Bacus, et al. v. CA & Spouses Faustino and Victoriana Duray, GR 127695, Dec. 3, 2001*).

(8) Case

Heirs of Luis Bacus, et al. v. CA & Spouses Faustino
and Victoriana Duray
GR 127695, Dec. 3, 2001

FACTS: When private respondents opted to buy the property, their obligation was to advise petitioners of their decision

and their readiness to pay the price. *Issue*: At this point in time, were respondents already obliged to make actual payment?

HELD: No. Only upon petitioners' actual execution and delivery of the deed of sale were they required to pay. The latter was contingent upon the former.

Art. 1157. Obligations arise from:

- (1) Law;**
- (2) Contracts;**
- (3) Quasi-contracts;**
- (4) Acts or omissions punished by law; and**
- (5) Quasi-delicts.**

COMMENT:

(1) Sources of Obligations

- (a) *Law* (obligations *ex lege*) — like the duty to pay taxes and to support one's family.
- (b) *Contracts* (obligations *ex contractu*) — like the duty to repay a loan by virtue of an agreement.
- (c) *Quasi-contracts* (obligations *ex quasi-contractu*) — like the duty to refund an "over change" of money because of the quasi-contract of *solutio indebiti* or "undue payment."
- (d) *Crimes or Acts or Omissions Punished by Law* (obligations *ex maleficio* or *ex delicto*) — like the duty to return a stolen carabao.
- (e) *Quasi-delicts or Torts* — (obligation *ex quasi-delicto* or *ex quasi-maleficio*) — like the duty to repair damage due to negligence.

(2) Criticism of the Enumeration Listed Down by the Law

The enumeration is not scientific because in reality there are only two sources: the law and contracts, because obligations arising from quasi-contracts, crimes, and quasi-delicts are really imposed by the law. (*Leung Ben v. O'Brien*, 38 Phil. 182).

(3) Offers of Reward in Newspaper or Public Contest

Although no express provision of law regulates said contests, it is understood that once contestants accept the offer by submitting entries, there is a sort of *implied contract* that prizes would eventually be awarded. It is understood that the rules of the contest form part of the contractual stipulations.

(4) Exclusiveness of the Enumeration

The enumeration by the law is *exclusive*; hence, no obligation exists if its source is not one of those enumerated under Art. 1157. (*Navales v. Rias*, 8 Phil. 508).

Art. 1158. Obligations derived from law are not presumed. Only those expressly determined in this Code or in special laws are demandable, and shall be regulated by the precepts of the law which establishes them; and as to what has not been foreseen, by the provisions of this Book.

COMMENT:**(1) Obligations Ex Lege****(a) Examples:**

- 1) the duty to support. (*Art. 291, Civil Code*).
- 2) the duty to pay taxes. (*National Internal Revenue Code*).

Canonizado v. Benitez
L-49315, L-60966, Feb. 20, 1984

The obligation of a married couple to support each other, under the law, generally subsists all throughout the marriage. If support which had been suspended is again invoked, a simple motion in the same proceeding will suffice. There is no necessity to file a separate action. (Note that in a very real sense, a final judgment for support can never be really final as the amount given may increase, decrease, or may even cease, at least, temporarily.)

- (b) No agreement is necessary before obligation *ex lege* can arise, but of course the law steps in only because of human actuations. For example, one who gambles and wins can be compelled by the loser to return the winnings. (*Art. 2014*). The action by the loser is called *indebitatus assumpsit*. (*Leung Ben v. O'Brien, 38 Phil. 182*).

Vda. de Recinto v. Inciong
77 SCRA 196

A person who buys another's property unaware of the right thereto of some other party is to be considered a buyer in good faith. While he is liable, his is the liability of a person in good faith.

Serrano v. Central Bank
L-30511, Feb. 14, 1980

The Central Bank (*now Bangko Sentral*) is NOT OBLIGED to pay the deposit of a depositor made in an insolvent bank.

(NOTE: *The Philippine Deposit Insurance Corporation* – PDIC – pays up to P100,000.00 per depositor).

Santos v. Court of Appeals
L-60210, Mar. 27, 1984

The right of pre-emption (right of first refusal) or redemption under PD 1517 refers only to urban *land* leased to a person who constructs his house thereon and who has leased the land for more than ten (10) years. The law does not apply if both the land and the house belong to the lessor. In the latter case, the lessor has no legal obligation to allow preemption or redemption.

Gonzales v. Philippine National Bank
GR 33320, May 30, 1983

The PNB is not an ordinary corporation and therefore not governed by the Corporation Law but by its own charter. A stockholder of the PNB cannot, therefore, insist on the inspec-

tion of its books. This can be done only by the Department of Supervision and Examination of the Central Bank (*now Bangko Sentral*).

(2) Meaning of the Article (BAR)

The law says “obligations derived from law are *not presumed*.” This merely means that the obligation must be clearly (expressly or impliedly) set forth in the law (the Civil Code or Special Laws). Thus, an employer is ordinarily not required to furnish his employees with *legal assistance*, for no law requires this. (*See De la Cruz v. Northern Theatrical Enterprises*, 50 O.G. 4225, Sept. 1954, where a movie house guard, forced to defend himself in court for killing a gate crasher, was acquitted but was not allowed to recover attorney’s fees from the theater owner.) In case of *overpayment* of taxes, the National Gov’t. cannot be required to pay interest on the amount refundable in the *absence* of a statutory provision expressly directing or authorizing such payment. (*Collector of Int. Rev. v. Fisher, et al.*, L-11622 and L-11668, Jan. 28, 1961).

Hilario Jaravata v. Sandiganbayan **L-56170, Jan. 31, 1984**

A high school principal *has no legal obligation* to facilitate the release of the salary differentials of the teachers under him. So if he receives reimbursement for his “expenses” or as “gifts,” he cannot be adjudged guilty under the Anti-Graft Law, for after all, he had no duty to do said facilitation.

(3) Conflict Between Civil Code and Special Laws

If regarding an obligation *ex lege*, there is a conflict between the New Civil Code and a special law, the latter prevails unless the contrary has been expressly stipulated in the New Civil Code. (*See Art. 18*).

Art. 1159. Obligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.

COMMENT:**(1) Obligations Ex-Contractu**

While obligations arising from a contract have the force of *law* between the parties, this *does not* mean that the law is inferior to contracts. This is because before a contract can be enforced, it must first be valid, and it cannot be valid if it is against the law. Moreover, the right of the parties to stipulate is limited. Hence, Art. 1306 of the Civil Code says: “The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided, they are not contrary to law, morals, good customs, public order, or public policy.”

As long as Art. 1306 is complied with, the contract should be given effect, even if at the time it was entered into, no legal provision existed governing it. (*Quizana v. Redugerio*, 50 O.G. 2444, Jun. 1954).

(2) Meaning of the Article

The Article means that neither party may unilaterally and upon his own exclusive volition, escape his obligations under the contract, unless the other party assented thereto, or unless for causes sufficient in law and pronounced adequate by a competent tribunal. (*L-10337, May 27, 1957*).

“Compliance in good faith” means that we must interpret “not by the letter that killeth but by the spirit that giveth life.” (*See William Golangco Construction Corp. v. PCIB*, 485 SCRA 203 [2006]).

**Martin v. Martin, et al.
L-12439, May 23, 1959**

Where the parties to a compromise agreement signed and executed the same WILLINGLY and VOLUNTARILY, they are BOUND by its terms, even if the COURT before which it was made had NO jurisdiction over the case. In a regime of law and order, the repudiation of an agreement validly entered into cannot be made without any justifiable reason. (*NOTE*: The approval of the court here is immaterial; what is important is the mutual consent to the compromise.)

**National Marketing Corp. (NAMARCO) v. Tan, et al.
L-17074, Mar. 31, 1964**

FACTS: On August 8, 1959, the Board of Directors of the FEDERATION of NAMARCO DISTRIBUTORS requested the President of the Philippines to allow the NAMARCO to purchase certain commodities, for distribution to the members of the FEDERATION. Upon endorsement by the President, the NAMARCO authorized the importation. When the Federation gave NAMARCO certain cash advances for the cost of importation, NAMARCO and the Federation executed a contract, whereby the former sold to the latter the goods to be imported. Part of the goods (when they arrived) was delivered to the Federation, but when a new Board took charge of the NAMARCO, the Board refused further delivery to outsiders. *Issue:* Was NAMARCO's action proper?

HELD: No, because it had entered into a valid contract with the Federation.

(3) The Right to Enter into Contracts

The right to enter into lawful contracts constitutes one of the liberties of the people of the State. If that right be struck down or arbitrarily interfered with, a substantial impairment of constitutional rights would result. (*People v. Pomar*, 46 Phil. 440). Nevertheless, in contracts where public interest is involved (as in the case of labor agreements), the government has a right to intervene for the protection of the whole. (*Leyte Land Trans. v. Leyte Farmer's Union*, GR L-1977, May 12, 1948).

(4) Differences Between an Obligation and a Contract

An obligation is the *result* of a contract (or some other source). Hence, while a contract, if valid, always results in obligations, not all obligations come from contracts. A contract always presupposes a meeting of the minds; this is not necessarily true for all kinds of obligations.

Be it noted, however, from another viewpoint that a contract may itself be the result of an obligation. Thus, if *P* engages *A* as the former's agent, we have the *contract* of agency. As an agent, *A* has the *obligation*, say to look around for clients or

buyers, as in the real estate business. As a result of such obligation, *A* may enter into a contract of sale with *C*, a customer. The contract of sale itself results in the *obligations* to pay and to deliver. The obligation to *deliver* may result in a contract of carriage, and so on, *ad infinitum*.

(5) Some Decided Cases

De los Reyes v. Alejado 16 Phil. 499

FACTS: A borrower agreed to pay his debt, and in case of non-payment, to render free service as a servant. **Issue:** Is the obligation valid?

HELD: The obligation to pay is, of course, valid and cannot be questioned but the undertaking to render domestic services for free is contrary to law and morals, for here, slavery would result. (**NOTE:** If, however, the “free” services will be rendered in *satisfaction* of the debt, the stipulation can be given effect, for here the services will *not* really be gratuitous. Even in this case, however, specific performance of the service will not be a proper remedy for non-compliance. Instead, an action for damages of payment of the debt should be brought.)

Molina v. de la Riva 6 Phil. 12

FACTS: The parties in a case agreed to go to court in Albay, although another Court has *jurisdiction*.

HELD: The agreement is null and void, for jurisdiction is conferred by law, and not by the will of the parties.

Bachrach v. Golingco 39 Phil. 138

ISSUE: If there is an express written contract for fees between an attorney and his client, may the court still disregard the contract?

HELD: Yes, because a contract for attorney’s fees is different from other contracts. It may be disregarded if the amount

fixed is unconscionable or unreasonable, considering the value of the work accomplished.

[NOTE: A claim for attorney's fees may be asserted either in the very action in which the services in question have been rendered, or in a separate action. If the first alternative is chosen, the court may pass upon said claim *even if its amount were less than the minimum prescribed* by law for the jurisdiction of the court over the subject matter of the case for so long as the main action is within the jurisdiction of said court, upon the theory that the right to recover attorney's fees is but an INCIDENT of the case in which the services of counsel have been rendered. (*Maria Reyes de Tolentino v. Godofredo Escalono, et al.*, L-26556, Jan. 24, 1960; see *Palanca v. Pecson*, 94 Phil. 419 and *Dahlke v. Vina*, 51 Phil. 707).]

Conrado v. Judge Tan
51 O.G. 2923, Jun. 1955

FACTS: In a validly made contract, some provisions were later on *inserted* by a falsifier. **Issue:** Is the whole contract void?

HELD: Only the additional provision should be disregarded, and the original terms should be considered valid and subsisting.

Alcantara v. Alinea
8 Phil. 111

FACTS: A borrowed from B P480 and agreed that in case of non-payment on the date stipulated, A's house and lot would be sold to B for the amount of P480. **Issue:** Is the stipulation valid?

HELD: Yes, and if A does not pay, A should sell the house and lot for P480. The agreement is not contrary to law. (*See also Quizana v. Redugerio*, 50 O.G. 2444, June, 1954).

(NOTE: It seems to the author that the stipulation may be considered void as being a *pactum commissorium*, unless A be allowed, instead of selling, to select the option of still being indebted, with consequential damages or interest.)

Ganzon v. Judge Sancho
GR 56450, Jul. 23, 1983

If a mortgage is substituted by a guaranty or surety bond without the consent of all the required parties, the contract may be said to be *impaired*.

Ollendorf v. Abrahamson
38 Phil. 585

FACTS: Ollendorf, needlework manufacturer, hired Abrahamson for *two* years, on the condition that for *five* years, the latter should not engage in *competitive* needlework manufacture. After one year, the latter left for reasons of health. Shortly afterwards, after regaining his health, he competed with his former employer, who now seeks to restrain him from such competition. The defendant argues that the restriction is void, because it is an unreasonable restraint of trade.

HELD: The agreement was valid, and is a reasonable restraint, considering that it was only for 5 years. Inasmuch as it is enforceable and has the rule of law between the parties, the defendant can be properly restricted.

Herminia Goduco v. Court of Appeals, et al.
L-17647, Feb. 28, 1964

If upon the promise of the son-in-law of a seller, an agent sells on commission a parcel of land to a buyer, said buyer, not having promised to give said commission, is NOT liable therefor. Payment of the commission must be sought from whoever made the promise to pay such amount, namely, the son-in-law of the seller.

Molave Motor Sales, Inc.
v. Laron and Geminiano
L-65377, May 28, 1984

When an employee in a car repair shop has his own car repaired therein and purchases certain spare parts, his liability therefor is governed by the Civil Code, not the Labor Code.

Therefore, it is the civil courts, not the Ministry (Department) of Labor, that has jurisdiction over the case.

Borcena, et al. v. IAC
GR 70099, Jan. 7, 1987

Contracts for attorney's services stand upon an entirely different footing from contracts for the payment of compensation for any other services. An attorney is not entitled, in the absence of express contract, to recover more than a reasonable compensation for his services. And even when an express contract is made, the court can ignore it and limit the recovery of reasonable compensation if the amount of the stipulated fee is found by the court to be unreasonable. This is a very different rule from that announced in Sec. 1091 of the Civil Code of Spain (now Art. 1159, Civil Code) with reference to the obligation of contracts in general, where it is said that such obligation has the force of law between the contracting parties.

PNB v. Se, Jr.
70 SCAD 323
(1996)

As contracts, warehouse receipts must be respected by authority of Art. 1159 of the Civil Code.

A prior judgment holding that a party is a warehouseman obligated to deliver sugar stocks covered by the Warehouse Receipts does not necessarily carry with it a denial of the warehouseman's lien over the same sugar stocks. Even in the absence of a provision in the Warehouse Receipts, law and equity dictate the payment of the warehouseman's lien pursuant to Sections 27 and 31 of the Warehouse Receipts Law.

A party is in estoppel in disclaiming liability for the payment of storage fees due the warehouseman while claiming to be entitled to the sugar stocks covered by the subject Warehouse Receipts on the basis of which it anchors its claim for payment or delivery of the sugar stocks. Imperative is the right of the warehouseman to demand payment of his lien because he loses his lien upon goods by surrendering possession thereof.

(6) The So-called Innominate Contracts

For want of an express name, the following are termed “*contratos innominados*”:

- (a) *Do ut des* — I give that you may give.
- (b) *Do ut facias* — I give that you may do.
- (c) *Facio ut des* — I do that you may give.
- (d) *Facio ut facias* — I do that you may do.

Example: A worked for B as interpreter. Even without an express agreement as to compensation, A is entitled to compensation because of *facio ut des* — I do the interpreting that you may give the money. (*Perez v. Pomar*, 2 *Phil.* 682).

**Vicente Aldaba v. Court of Appeals, et al.
L-21676, Feb. 28, 1969**

FACTS: Dr. Vicente Aldaba and his daughter, Dr. Jane Aldaba, rendered services to Belen Aldaba, a rich woman of Malolos, Bulacan for 10 years without receiving any compensation. It was admitted that for such services, the two doctors did NOT expect to be paid. **Issues:** Was there a contract, whether express or implied? Was Belen obliged to compensate the two doctors?

HELD: There was *no* contract, whether express or implied, and therefore Belen was *not* obliged to compensate the *two* doctors; *no* express contract, for nothing on this point was agreed upon; and *no* implied contract, for the doctors did *not expect* to be paid for their services. When a person does not expect to be paid for his services, there cannot be a contract implied in fact to give compensation for such services. To give rise to an implied contract to pay for services, said services must have been rendered by one party in expectation that the other party would pay for them and must have been accepted by the other party with knowledge of that expectation. (*See 58 Am. Jur.*, p. 512, and the cases cited therein).

Art. 1160. Obligations derived from quasi-contracts shall be subject to the provisions of Chapter 1, Title XVII, of this Book.

COMMENT:**(1) ‘Quasi-Contract’ Defined**

A quasi-contract is that juridical relation resulting from a lawful, voluntary, and unilateral act, and which has for its purpose the payment of indemnity to the end that *no one shall be unjustly enriched or benefited at the expense of another*. (See Art. 2142, Civil Code).

(2) The 2 Principal Kinds

- (a) *negotiorum gestio* (unauthorized management)
- (b) *solutio indebiti* (undue payment)

(3) Negotiorum Gestio

This takes place when a person *voluntarily* takes charge of another’s abandoned business or property *without* the owner’s authority. (Art. 2144, Civil Code). Reimbursement must be made to the *gestor* for necessary and useful expenses, as a rule. (See Art. 2150, Civil Code).

(4) Solutio Indebiti

This takes place when something is received when there is no right to demand it, and it was unduly delivered thru mistake. The recipient has the duty to return it. (*Example*: If I let a storekeeper change my P50.00 bill and by error he gives me P50.60, I have the duty to return the extra P0.60). (See Art. 2154, Civil Code).

City of Cebu v. Piccio and Caballero
L-13012 and 14876, Dec. 31, 1960

FACTS: Caballero, an employee of the City of Cebu who has been *illegally* dismissed, sued for *backwages* by way of mandamus and made as defendants thereto the City Mayor, the Municipal Board, the City Treasurer, and the City Auditor of Cebu City, BUT the City of Cebu itself was not made a defendant. When Caballero was later *paid*, the City of Cebu brought an action for the REFUND of the payment on the ground that

the payment was illegal because the City of Cebu had NOT been made a party to Caballero's *mandamus* case.

HELD: The City of Cebu CANNOT recover. The claim for refund is predicated on "*solutio indebiti*." The requisites for this are: (a) he who paid was NOT under obligation to do so; (b) the payment was made by reason of an essential mistake of fact. These requisites are NOT present because Caballero has a right to be paid and no mistake was made. The fact that the City itself was NOT a party is *immaterial* for a judgment against a *municipal officer*, sued in his *official* capacity, BINDS the City. The acts of the duly authorized officials *bind* the principal — the city.

**UST Cooperative Store v. City of Manila, et al.
L-17133, Dec. 31, 1965**

FACTS: The UST Cooperative Store, which is tax-exempt under RA 2023 (The Philippine Non-Agricultural Cooperative Act) because its assets are not more than P500,000 *paid taxes* to the City of Manila, not knowing that it was tax-exempt. **Issue:** May it successfully ask for a *refund*?

HELD: Yes, because the payment is not considered voluntary in character. Clearly, the payment was made under a mistake. (*See 51 Am. Jur. 1023*).

(5) Query: Is a Quasi-Contract an Implied Contract?

ANS.: No, because in a quasi-contract (unlike in an implied contract) there is NO meeting of the minds.

(6) Other Examples of Quasi-Contracts

- (a) When during a fire, flood, or other calamity, property is saved from destruction by another person without the knowledge of the owner, the latter is bound to pay the former just compensation. (*Art. 2168, Civil Code*).
- (b) Any person who is *constrained* to pay the taxes of another shall be entitled to reimbursement from the latter. (*Art. 2175, Civil Code*).

(7) No Unjust Enrichment**Lirag Textile Mills, Inc. v. Reparations Commission
79 SCRA 675**

If the price of certain goods is determined, considering the rate of exchange at the time of its procurement, there is no unjust enrichment involved.

Art. 1161. Civil obligations arising from criminal offenses shall be governed by the penal laws, subject to the provisions of Article 2177, and of the pertinent provisions of Chapter 2, Preliminary Title, on Human Relations, and of Title XVIII of this Book, regulating damages.

COMMENT:**(1) Obligations Ex Delicto or Ex Maleficio**

Governing rules (BAR QUESTION)

- (a) Pertinent provisions of the Revised Penal Code and other penal laws, subject to the provisions of Art. 2177, Civil Code.
- (b) Chapter 2, Preliminary Title, on Human Relations (of the Civil Code).
- (c) Title 18 of Book IV of the Civil Code — on *damages*.

**Badiong v. Judge Apalisok
GR 60151, Jun. 24, 1983**

Although the defendant in a criminal case has already pleaded guilty, and has filed an application for probation, the court should still set the case for hearing to receive the offended party's evidence on the civil liability of the accused. If this would not be done, the offended party will be denied due process.

(2) Pertinent Provision of the Revised Penal Code

Art. 100, R.P.C. says: "Every person criminally liable for a felony is also civilly liable." The reason lies in the fact that

oftentimes the commission of a crime causes not only moral evil but also material damage. If no material damage is done, civil liability cannot be enforced. (*See Albert, Rev. Penal Code, Vol. I, pp. 407-408*).

Elcano v. Hill
77 SCRA 98

An accused in a criminal case may be sued CIVILLY whether or not he is found guilty or is acquitted. But the victim cannot recover damages in both cases (only in one).

(3) Liability of an Insane Criminal

An insane man who commits a crime is exempted from criminal liability, but his guardian can be held civilly liable unless the latter was diligent in his task of taking care of the insane. If there is no guardian, or if said guardian (in the proper case) is insolvent, the property of the insane man can be made liable. (*See Arts. 12 and 101, R.P.C.*).

(4) Case

Sales v. Balce
L-14414, Apr. 27, 1960

FACTS: The son of the plaintiff was killed by the minor son (below 15) of the defendant. The son who acted with discernment was convicted, but had no money. *Issue:* Are his parents subsidiarily liable?

HELD: Art. 101 of the Revised Penal Code prescribes the subsidiary liability of the parents in case of a minor over 9 but under 15 who DID NOT act with discernment. If he acted WITH discernment, the Revised Penal Code is silent because he is criminally liable. In that case, resort is made to the general law which is the Civil Code, Art. 2080 of which applies. Under said Article, the parents would be held liable unless they can prove due supervision. To hold that the Civil Code does not apply because it covers only obligations arising from negligence or *quasi-delicts* would result in an ABSURDITY for, while in a negligent act, the parents are subsidiarily liable for the damage

caused by their son, no liability would attach if the damage is caused with criminal intent. It is clear, therefore, that applying Art. 2080 of the Civil Code, the parents would ordinarily be liable.

(5) What Civil Liability Arising from a Crime Includes

- (a) restitution;
- (b) reparation of the damage caused;
- (c) indemnification for consequential damages. (*Art. 104, Rev. Penal Code*).

(NOTE: In the case of *People v. Rodriguez*, GR L-6592, July 29, 1956, it was held that if a criminal is convicted *without* the court declaring his civil liability and he immediately *commences* serving sentence, the court may still grant indemnity, upon motion of the victim, 3 days after the criminal began to serve sentence, because the judgment has not yet become final, for the period to appeal *has* not yet prescribed. In *another* case, *People v. Mostasesa*, GR L-5684, Jan. 22, 1954, it was held that if a person commits a crime by taking something, he *cannot* discharge his civil liability by offering to give a *similar* thing. He must pay the *price*, for the civil liability arising from a crime is not governed by the Civil Code but by Arts. 100-111, Rev. Penal Code.)

(6) Effect of Aggravating and Mitigating Circumstances

In crimes, the damages to be adjudicated may be, respectively, *increased* or *lessened* according to the aggravating or mitigating circumstances. (*Art. 2204, Civil Code*).

(7) Damages in Case of Death

In addition to other damages, if a crime results in death, Art. 2206 of the Civil Code states that at least three thousand pesos must be given to the heirs of the victim. However, said minimum amount has now been raised to P50,000 in view of the decreasing value of the peso. (Loss of earning capacity and moral damages, among other things, should be given.)

(8) Civil Action Implicitly Instituted in Criminal Case

As a *general rule*, whenever a criminal action is instituted, the civil action for the civil liability is also impliedly instituted together with the criminal action. (*See Rule 3, Sec. 1, Revised Rules of Court*).

(9) Effect of Death of the Criminal Offender Pending Trial**Buenaventura Belamala v. Marcelino Polinar****L-24098, Nov. 18, 1967**

FACTS: The defendant in a criminal case for physical injuries died before final judgment. *Issue:* Is his civil liability extinguished?

HELD: No, his civil liability is not extinguished for, after all, in Art. 33 of the Civil Code, there can, in the case of physical injuries, still be an independent civil action. The action will be directed against the administrator of the estate, the obligation having become the obligation of the heirs; but of course the liability cannot exceed the value of the inheritance. (*Art. 774, Civil Code*). Incidentally, as already said, the remedy is an action against the administrator, and *not* merely a claim against the estate. The reason is because the purpose is to recover damages for an injury to *person* or property (hence, extra-contractual as it arose from either a crime or a tort). (*See Aguas v. Llemos, L-18107, Aug. 30, 1962*). Had the liability been contractual, a mere claim against the estate would have sufficed. (*See Leung Ben v. O'Brien, 38 Phil. 182*).

Lamberto Torrijos v. Court of Appeals**L-40336, Oct. 24, 1975**

FACTS: In 1964, Torrijos purchased a lot from Diamnuan. Later, Torrijos learned that in 1969, Diamnuan sold the same lot to De Guia. Torrijos initiated an estafa complaint against the seller, who was eventually convicted by the CFI (now RTC). During the pendency of the case in the Court of Appeals, the accused Diamnuan died. His lawyer filed a motion to dismiss the case alleging that the death of his client, prior to final judgment, extinguished both the personal and the pecuniary penalties.

Issue: Is the civil liability also extinguished? Should the case be dismissed?

HELD: The civil liability here is not extinguished, because *independently* of the criminal case, the accused was civilly liable to Torrijos. If after receiving the purchase price from Torrijos, he failed to deliver the property (even before selling it again to De Guia), there would as yet be no estafa, but there is no question of his civil liability thru an action by Torrijos either for specific performance plus damages, or rescission plus damages. Death is not a valid cause for the extinguishment of a civil obligation. Had the only basis been the commission of estafa, it is clear that the extinguishment of the criminal responsibility would also extinguish the civil liability, provided that death comes before final judgment.

Furthermore, under Arts. 19, 20, and 21 of the Civil Code, the accused would be civilly liable independently of the criminal liability for which he can be held liable. And this civil liability exists despite death prior to final judgment of conviction.

The case, therefore, cannot as yet be dismissed.

(10) Kind of Proof Needed

- (a) If a *civil* action merely is instituted, mere preponderance of evidence is sufficient.
- (b) If a *criminal* case is brought (and with it, the civil case), the guilt must be established by proof *beyond reasonable doubt*.

(11) Effect of Acquittal in Criminal Case

Suppose a defendant in a criminal case is *acquitted*, can he still be held liable *civilly*?

ANS.: It depends.

- (a) If the reason why there was an acquittal was because the accused *could not* have committed the act (as when he was in another country at the time he was supposed to have murdered somebody in the Philippines), no civil action can later on be brought.
- (b) If the reason for the acquittal was because of an *exempting circumstance* (as in the case of an insane defendant), he

would *still* be civilly liable (if he has no guardian, or if the guardian who may under the circumstance be ordinarily liable, is insolvent).

- (c) If there is an *independent civil action* allowed by the law, civil liability may still *arise* if this action is instituted and the defendant's liability is proved by *mere preponderance of evidence* (because while guilt beyond reasonable doubt might not have been proved, it would be a *simpler* matter to prove guilt by mere preponderance of evidence).

**Co San v. Director of Patents, et al.
L-10563, Feb. 23, 1961**

A judgment of acquittal in a criminal action for *fraudulent registration of a trademark* in violation of Sec. 18 of Act No. 666, *cannot* be invoked as *res judicata* in a civil action based on *unfair and malicious competition* on the ground that the facts of the latter are different and have not been passed upon in the judgment rendered in the former case. (*See Ogura v. Chua and Confesor, 50 Phil. 471*).

(12) Example of Independent Civil Actions

“In cases of *defamation* (libel, slander), *fraud* (estafa, deceit), and *physical injuries* (including attempted, frustrated, or consummated homicide, murder, parricides or infanticide) a *civil action* for damages, entirely *separate* and *distinct* from the criminal action may be brought by the injured party (or his heirs). Such civil action shall proceed independently of the criminal prosecution, and shall require only a preponderance of evidence.” (*Art. 33, Civil Code*).

(13) Effect of Reservation of the Civil Aspect

**Jovencio Luansing v. People of the
Philippines & Court of Appeals
L-23289, Feb. 28, 1969**

FACTS: In a criminal action for seduction, the offended party expressly reserved the right to file a separate civil action.

The CFI (now RTC) found the accused guilty, and imposed civil liabilities. No motion for reconsideration was filed by the offended party. *Issue*: Was the imposition of civil liability proper, despite the reservation?

HELD: No, the imposition of the civil liability was not proper because:

- (a) there was the reservation as to the civil aspect;
- (b) the mere failure to file a motion for reconsideration does not necessarily result in waiver or abandonment. Abandonment requires a more convincing quantum of evidence than mere forbearance to actually file the civil action, especially when we consider the fact that the same could be filed even after the decision in the criminal case had been rendered;
- (c) proof should be given with respect to the amount.

(14) Is There Need of Making a Reservation of the Civil Case (Where the Law Grants an *Independent Civil Action*) if a Criminal Case is First Brought to Court?

Under Rule 111, Secs. 1 and 3 of the New Rules on Criminal Procedure, the answer is YES. In the case of *Garcia, et al. v. Judge Florido*, L-35095, Aug. 31, 1973, the Court ruled that while a reservation is indeed required, the reservation need *not* be made at the time the criminal proceedings are filed, if the offended parties had no chance to do so (as when they were still in a hospital, as a result of injuries suffered in a vehicular accident, at the time the criminal suit against the erring driver was filed). However, in the case of *Crispin Abellana, et al. v. Judge Maraue*, L-27760, May 29, 1974, the Court said that Rule 111 of the New Rules on Criminal Procedure, insofar as it requires a *reservation* even in the case of an *independent civil action*, is of doubtful constitutionality inasmuch as the Rules of Court cannot amend substantial law, like the Civil Code.

Garcia v. Florido
L-35095, Aug. 31, 1973

FACTS: After a vehicular accident, the victims were brought to the hospital for treatment. In the meantime, the

police authorities filed a criminal case of reckless imprudence resulting in physical injuries, WITHOUT making a reservation as to the civil aspect. When the victims became well enough to go to court, they decided to file a *civil case* despite the pendency of the criminal case. *Issue*: Should the civil case be allowed, despite the pendency of the criminal proceedings?

HELD: Yes, for while it is true that a reservation should have been made under Rule 111 of the New Rules on Criminal Procedure (though such rule has been assailed by SOME in this respect as virtually eliminating or amending the “substantive” right of allowing an “independent civil action,” as ordained by the Civil Code) *still the Rule does not state when the reservation is supposed to be made*. Here the victims had no chance to make the reservation (for they were still at the hospital); moreover, *the trial has not even begun*. It is, therefore, not yet too late to make the reservation; in fact, the actual filing of the civil case, though at this stage, is even better than the making of the reservation.

**Crispin Abellana and Francisco Abellana v.
Hon. Geronimo R. Maraue and
Geronimo Companer, et al.
L-27760, May 29, 1974**

FACTS: Francisco Abellana was driving a cargo truck when he hit a motorized pedicab. Four of the passengers of the pedicab were injured. He was tried in the City Court of Ozamis for reckless imprudence (no reservation was made as to any civil action that might be instituted); he was convicted. He then appealed to the Court of First Instance (now Regional Trial Court [RTC]). During the pendency of the appeal (and in fact, before trial in the CFI [now RTC]), the victims decided to make a WAIVER re claim for damages in the criminal case, and RESERVATION with respect to the civil aspects. The victims then in another Branch of the CFI [now RTC] allowed the FILING of the civil case. The accused objected to the allowance on the theory that in the *City Court* (original court) *no reservation* has been made, thus, the civil aspect should be deemed included in the criminal suit, conformably with Rule 111 of the New Rules on Criminal Procedure. The CFI (RTC) maintained that the civil case should be allowed because, with the appeal, the judgment

of the City Court had become *vacated* (said court was then not a court of record) and in the CFI (RTC) the case was to be tried anew (trial *de novo*). This ruling of the CFI (RTC) was elevated to the Supreme Court on *certiorari*. *Issue*: May a civil case still be brought despite the appeal in the criminal case?

HELD: Yes, for three reasons:

- (a) *Firstly*, with the appeal, the original judgment of conviction was VACATED; there will be a trial *de novo* in the CFI (RTC), a trial that has not even began; therefore, a reservation can still be made and a civil action can still be allowed.
- (b) *Secondly*, to say that the civil action is barred because no reservation (pursuant to Rule 111) had been made in the City Court when the criminal suit was filed is to present a grave constitutional question, namely, can the Supreme Court, in Rule 111 amend or restrict a SUBSTANTIVE right granted by the Civil Code? This cannot be done. The apparent *literal* import of the Rule cannot prevail. A judge “is not to fall prey,” as admonished by Justice Frank Frankfurter, “to the vice of literalness.”
- (c) *Thirdly*, it would be UNFAIR, under the circumstances, if the victims would not be allowed to recover any civil liability, considering the damage done to them.

(15) Recovery of Damages in SAME CASE Despite Acquittal

Roy Padilla v. Court of Appeals L-39999, May 31, 1984

If a person is acquitted in a criminal case on reasonable doubt, he may, in the very same criminal case, be held liable for *damages*, if this is warranted by the evidence that had been adduced. There is no need to institute a separate civil suit for damages.

People v. Castañeda GR 49781, Jun. 24, 1983

If a person is not criminally liable, it does not necessarily follow that he is also not civilly liable. He may indeed be civilly

responsible. Thus, he may still be sued civilly for the same act.

People v. Teresa Jalandoni
GR 57555, Aug. 28, 1984

Even if an accused in an estafa case is *acquitted* on reasonable doubt she *may still be held civilly liable*, following the ruling in *Padilla v. Court of Appeals, L-39999, May 31, 1984*.

(16) Affidavit of Desistance

People v. Entes
L-50632, Feb. 24, 1981

Affidavits of desistance (such as an express pardon in private crimes after the filing of the criminal case) do not justify the dismissal of a criminal complaint.

People v. Mayor Caruncho, Jr.
L-57804, Jan. 23, 1984

- (1) A compromise on the civil liability of a person for having committed a crime does not extinguish his criminal or penal liability.
- (2) If a municipal judge dismisses a criminal case for “slight physical injuries” on account of a voluntary affidavit of desistance, while this may be an “abuse of discretion,” there cannot be a “grave abuse of discretion.” Thus, a petition for *certiorari* re the dismissal of the case will FAIL or BE DENIED.

(17) Effect of Non-Allegation of Damages

Badiong v. Judge Apalisok
GR 60151, Jun. 24, 1983

In a criminal case, civil liability may be claimed even if there is no specific allegation of damages in the information or complaint that has been filed.

Art. 1162. Obligations derived from quasi-delicts shall be governed by the provisions of Chapter 2, Title XVII of this Book, and by special laws.

COMMENT:

(1) Obligations Ex Quasi-Delicts or Ex Quasi-Maleficio

Governing laws (Bar Question)

- (a) Chapter 2, Title 17, Book IV, Civil Code
- (b) Special Laws

(2) Another Name for Quasi-Delict

Another name for quasi-delict is “tort” or “*culpa aquiliana*.”

(3) Definition of ‘Quasi-Delict’

A quasi-delict is a fault or act of negligence (or omission of *care*) which causes damages to another, there being no pre-existing contractual relations between the parties.

[NOTE: If a person is sued for causing damage thru the violation of traffic rules, the accusation is one actually referring to negligence or *quasi-delict* or *culpa aquiliana*. “Violation of traffic rules” is merely descriptive of the failure of the driver to observe, for the protection of the interests of others, that degree of care, precaution, and vigilance which circumstances justly demand, which failure results in injury on claimants. Excessive speed in violation of traffic rule is a clear indication of negligence. (*Garcia, et al. v. Judge Florido, CFI, Misamis Oriental, et al., L-35095, Aug. 31, 1973*).]

**Elcano v. Hill
77 SCRA 98**

Culpa aquiliana (quasi-delicts) can refer to acts which are criminal in character, whether the same be voluntary or negligent.

(4) Examples

- (a) While driving a car recklessly, I injured a pedestrian.
- (b) While cleaning my window sill, my negligence caused a flower pot to fall on the street, breaking the arms of my neighbor.

(NOTE: In the above examples, I can also be charged with the crime of physical injuries thru simple or reckless imprudence.)

(5) Definitions of Negligence (Culpa)

- (a) “Negligence is the failure to observe, for the protection of the interests of another person, that degree of care, precaution, and vigilance which the circumstances justly demand, whereby such other person suffers injury.” (*U.S. v. Barrias*, 23 Phil. 434).
- (b) As defined by the Civil Code, negligence is the omission of that diligence which is required by the circumstances of person, place, and time. (*See Art. 1173*). Thus, negligence is a question of fact. (*See Tucker v. Milan*, [C.A.] 49 O.G. 4397, Oct. 1953).

(6) Test for Determination of Negligence

“The test in determining whether a person is negligent . . . is this: Would a prudent man (in his position) *foresee harm* to the person injured as a reasonable consequence of the course about to be pursued? If so, the law imposes a duty on the actor to refrain from that course, or to take precaution against its mischievous results, and the failure to do so constitutes negligence. Reasonable foresight of harm, followed by the ignoring of the admonition born of this provision, is the constitute fact of negligence.” (*Picart v. Smith*, 37 Phil. 809).

(7) Requirements Before a Person Can Be Held Liable for a Quasi-Delict

- (a) there must be fault or negligence attributable to the person charged;
- (b) there must be damage or injury;

- (c) there must be a direct relation of cause and effect between the fault or negligence on the one hand and the damage or injury on the other hand (*proximate cause*).

[NOTE:

- 1) *Proximate cause* is that adequate and efficient cause, which in the natural order of events, necessarily produces the damages or injury complained of.

In the case of *Tuason v. Luzon Stevedoring Co., et al.*, L-13541, Jan. 28, 1961, the Supreme Court held that since the plaintiff, Eduardo Tuason, was traveling at a very high rate of speed, and on the wrong side of the road, his negligence was the *proximate cause* of the accident which badly injured him, and therefore he cannot recover damages from the other party in the collision.

- 2) There are instances when “although there is damages, there is no legal injury or wrong” (*damnum absque injuria* — damage without legal injury). (*Example: If a carefully-driven car causes damage to a pedestrian because the driver was suddenly struck by lightning, this is an instance of damage without injury.*)]

(8) Culpa Aquiliana of Married Minors

Elcano v. Hill 77 SCRA 98

If a married minor commits a quasi-delict or *culpa aquiliana*, his parents would be liable if said minor lives with, and is dependent on, them.

(9) Violation of an Obligation

Mascunana v. Verdeflor 79 SCRA 339

Owners of land fronting a public street have a cause of action against a municipal council resolution that has ordered the closure of said street to vehicular traffic.

Chapter 2

NATURE AND EFFECT OF OBLIGATIONS

Art. 1163. Every person obliged to give something is also obliged to take care of it with the proper diligence of a good father of a family, unless the law or the stipulation of the parties requires another standard of care.

COMMENT:

(1) Duty to Exercise Diligence

This Article deals with the first effect of an obligation to deliver a *determinate* thing (as distinguished from a *generic* thing — or one of a class) — namely — the duty to exercise proper diligence. Unless diligence is exercised, there is a danger that the property would be lost or destroyed, thus rendering illusory the obligation. (See 8 Manresa 35-36).

(2) Diligence Needed

- (a) That which is required by the *nature* of the obligation and corresponds with the circumstances of *person, time, and place*. (Art. 1173, Civil Code). This is *really* diligence of a good father of a family.
- (b) However, if the *law* or *contract* provides for a *different* standard of care, said law or stipulation must prevail. (Art. 1163, Civil Code).

[Example of a case where the law requires *extraordinary* care (not merely that of a *prudent* man):

“A common carrier is bound to carry the passengers safely *as far as human care and foresight* can provide, using the utmost diligence of very cautious persons, with a due regard for all the circumstances.” (Art. 1755, Civil Code).]

(3) Some Cases**Obejera, et al. v. Iga Sy**
76 Phil. 580

FACTS: During the Japanese occupation, *A* and *B* sought refuge in the house of a certain Villena in Batangas, Batangas. When the Japanese neared the place, *A* and *B* hid their valuables in Villena's dugout. Later, the valuables were lost. *A* claimed that he had given his things to *B* as a *deposit*, and that therefore *B* should be liable for the loss. *B* denied the existence of such deposit. Decide the question of liability.

HELD: In the first place, it is hard to believe that *B* consented to safeguard the valuables at a time when no one could be sure of his own life. In the second place, granting that *B* had assumed the obligation to take care of the property, still considering the circumstances of the time and place, the obligation to return the valuables was extinguished by the loss of the thing thru something which was not the fault of *B*.

Bishop of Jaro v. De la Peña
26 Phil. 144

FACTS: A priest, A. de la Peña, was the custodian of certain charity funds (P6,641) which he deposited together with his personal account of (P19,000) in an Iloilo Bank shortly before the American invasion of the Philippines. During the revolution, Peña became a political prisoner and his bank deposit was confiscated on the ground that they were being used for revolutionary purposes. *Issue:* Is he liable for the loss of the trust funds?

HELD: No, because negligence did not exist in his depositing the money with the bank. It is as if the money was taken from him by force and clearly, he should not be responsible.

Bernabe Africa, et al. v. Caltex, et al.
L-12986, Mar. 31, 1966

FACTS: A fire broke out at a Caltex service station. It started while gasoline was being hosed from a tank truck into the underground storage, right at the opening of the receiving

tank where the nozzle of the hose had been inserted. The fire destroyed several houses. Caltex and the station manager were sued. *Issue*: Without proof as to the cause and origin of the fire, would the doctrine of *res ipsa loquitur* apply such that the defendants can be presumed negligent?

HELD: Yes, for the gasoline station was under the care of the defendant, who gave no explanation at all regarding the fire. It is fair to reasonably infer that the incident happened because of their want of care.

Ronquillo, et al. v. Singson
CA, L-22612-R, Apr. 22, 1959

FACTS: A man ordered a ten-year-old boy, Jose Ronquillo, to climb a high and rather slippery santol tree, with a promise to give him part of the fruits. The boy was killed in the act of climbing. *Issue*: Is the person who ordered him liable?

HELD: Yes, in view of his negligent act in making the order. He did not take due care to avoid a reasonably foreseeable injury to the 10-year-old boy. The tree was a treacherous one, a veritable trap. His act was clearly a departure from the standard of conduct required of a prudent man. He should have desisted from making the order. Since he failed to appreciate the predictable danger and aggravated such negligence by offering part of the fruits as a reward, it is clear that he should be made to respond in damages for the actionable wrong committed by him.

Art. 1164. The creditor has a right to the fruits of the thing from the time the obligation to deliver it arises. However, he shall acquire no real right over it until the same has been delivered to him.

COMMENT:

(1) When Creditor Is Entitled to the Fruits

Example: A is obliged to give B on Dec. 3, 2004, a particular parcel of land. (Before Dec. 3, he has no right whatsoever over the fruits). After Dec. 3, 2004, B, the creditor is entitled (as of

right) to the fruits. But if the fruits and the land are *actually or constructively delivered* only on Dec. 15, 2004, *B* becomes owner of said fruits and land only from said date. Between Dec. 3 and Dec. 15, *B* had only a *personal* right (enforceable against *A*); after Dec. 15, he has a *real right* (over the properties), a right that is enforceable against the *whole world*.

[NOTE: A *personal* right is also called *jus in personam* or *jus ad rem*; a *real right* is a *jus in re*. (See *Fidelity and Deposit Co. v. Wilson*, 8 Phil. 51). A *personal* right is power demandable by one person of another — to give, to do, or not to do (3 *Sanchez Roman* 6, 8); a *real right* is a power over a *specific thing* (like the right of *ownership* or *possession*) and is binding on the whole world. (See 3 *Sanchez Roman* 6, 8).]

[NOTE: In the case of a purchase of land, for example, *before* the land is delivered, the proper remedy of the buyer (since he is not yet the owner) is to compel *specific performance* and *delivery*, and *not* an *accion reivindicatoria* (for the latter remedy presupposes *ownership*). (See *Garchitorena v. Almeda*, [C.A.] 48 O.G. 3432; see also *Cruzado v. Bustos & Escaler*, 34 Phil. 17).]

(2) Latin Maxim (Re Delivery and Ownership)

“Non nudis pactis, sed traditionis dominia rerum transferantur.” (As a consequence of certain contracts, it is not agreement but *tradition* or *delivery* that transfers ownership). (10 *Manresa* 339 and *Fidelity & Deposit Co. v. Wilson*, 8 Phil. 51).

(3) Kinds of Delivery

Delivery may be either *actual* or *constructive*.

- (a) *Actual delivery* (or *tradition*) — where physically, the property changes hands. *Example*: If *A* sells *B* a fountain pen, the *giving* by *A* to *B* of the fountain pen is *actual tradition*.
- (b) *Constructive delivery* — that where the physical transfer is *implied*. This may be done by:
 - 1) *traditio simbolica* (symbolical tradition) — (as when the *keys* of a *bodega* are given)

- 2) *traditio longa manu* (delivery by mere consent or the pointing out of the object) (Etymologically, “the extending of the hand.”) *Example*: pointing out the car, which is the object of the sale.
- 3) *traditio brevi manu* — (delivery by the short hand; that kind of delivery whereby a possessor of a thing *not* as an owner, becomes the possessor as owner) (*Example*: when a *tenant* already in possession *buys* the house he is renting).
- 4) *traditio constitutum possessorium* — the opposite of *brevi manu*; thus, the delivery whereby a possessor of a thing as an owner, *retains* possession no longer as an owner, but in some other capacity (like a house owner, who *sells* a house, but remains in possession as *tenant* of the same house).
- 5) *tradition by the execution of legal forms and solemnities* (like the execution of a public instrument selling land).

[NOTE: A sale which is simulated, or even a genuine one, where there is no *delivery* of the object, does not transfer ownership. (See *Cruzado v. Bustos & Escaler*, 34 Phil. 17).]

(4) Delivery of Ideal Share

Gatchalian v. Arlegui 75 SCRA 234

When by virtue of a court judgment, a person is ordered to deliver to another the possession of a *pro indiviso* or *ideal* share of property, owned in common, it is understood that what is contemplated is symbolical or constructive delivery, not material or actual delivery.

(5) When Does the Obligation to Deliver Arise?

ANS.: It depends:

- (a) If there is no term or condition, then from the perfection of the contract.

- (b) If there is a term or a condition, then from the moment the term arrives or the condition happens. (*See 8 Manresa 44-45*).

Art. 1165. When what is to be delivered is a determinate thing, the creditor, in addition to the right granted him by Article 1170, may compel the debtor to make the delivery.

If the thing is indeterminate or generic, he may ask that the obligation be complied with at the expense of the debtor.

If the obligor delays, or has promised to deliver the same thing to two or more persons who do not have the same interest, he shall be responsible for fortuitous event until he has effected the delivery.

COMMENT:

(1) Classification of Obligation from the Viewpoint of Subject Matter

From the viewpoint of the *subject matter* (or object) of the obligation, obligations are divided into:

- (a) *real* obligations (to give):
 - 1) to give a *specific* thing (*set apart* from a class);
 - 2) to give a *generic* or *indeterminate* thing (one of a class).
- (b) *personal* obligations (to do or not to do).

(2) Specific or Determinate Things

A thing is said to be *specific* or *determinate* when it is capable of particular designation.

Examples:

- (a) this car
- (b) the car owned by A on Sept. 12, 2005
- (c) the car with plate number 1814 (2005)

- (d) this particular picture of Maui in my notebook

(3) Generic or Indeterminate Things

A thing is *generic* or *indeterminate* when it refers only to a class, to a genus, and cannot be pointed out with particularity.

Examples:

- (a) a car
- (b) a 2005 BMW automobile
- (c) the sum of P5 million
- (d) a kilo of sugar

(4) Remedies of the Creditor When the Debtor Fails to Comply With His Obligation

- (a) demand specific performance (or compliance) of the obligation. (This is true whether the obligation be *generic* or *specific*.)
- (b) demand rescission or cancellation (in some cases).
- (c) demand *damages* either *with* or *without* either of the first two, (a) or (b).

(NOTE: If I am entitled to 10 kilos of sugar from A, I can demand that A obtain the sugar and give me 10 kilos thereof. This is true even if the obligation here be *generic*. A *cannot* insist on just paying me damages or the monetary value of the sugar. Upon the other hand, if I desire to, I can just buy 10 kilos of sugar anywhere and charge the expense to A.).

Uy v. Puzon 79 SCRA 598

If a partner in a construction enterprise fails to fulfill his commitments to the partnership, he is required to indemnify his co-partner for the latter's losses, such as the money invested or spent by the latter.

(5) Case (Re Imprisonment Because of a Debt)**Rufo Quemuel v. Court of Appeals
L-22794, Jan. 16, 1968**

FACTS: Rufo Quemuel was convicted by the Court of First Instance (now Regional Trial Court) of Rizal of the crime of libel. The conviction was affirmed by the Court of Appeals. On appeal to the Supreme Court, he alleged, among other things:

- (a) That there was no proof that damages had been sustained by the offended party; and
- (b) That subsidiary imprisonment for non-payment of the indemnity constitutes imprisonment for non-payment of debt and is therefore unconstitutional.

HELD:

- (a) As regards the alleged absence of proof that the offended party has suffered mental anguish, loss of sleep, or could not look at his neighbor straight in the eye, suffice it to stress that by its very nature, libel causes dishonor, disrepute and discredit; that the injury to the reputation of the injured party is a natural and probable consequence of the defamatory words in libel cases; that where the article is libelous *per se* — “the law implies damages;” and that the complainant in libel cases is “not required to introduce evidence of actual damages,” at least, when the amount of the award is more or less nominal.
- (b) The civil liability arising from libel is not a “debt,” within the purview of the constitutional provision against imprisonment for non-payment of a “debt.” Insofar as said injunction is concerned, “debt” means an obligation to pay a sum of money “arising from contract” express or implied. In addition to being part of the penalty, the civil liability in the present case arises from a tort or crime, and hence, from law. As a consequence, the subsidiary imprisonment for non-payment of said liability does not violate the constitutional injunction.

[*NOTE:* Under a comparatively new Republic Act, courts can *no longer* impose subsidiary imprisonment in

case of civil liability arising from a crime precisely on the theory that said subsidiary imprisonment would seem to violate the constitutional injunction. However, if *finés* (not civil liabilities) are unpaid to the State (note that civil liabilities go to offended private parties), subsidiary imprisonment can be imposed (provided the decision of the court imposes such subsidiary imprisonment).]

(6) Effect of Fortuitous Events

Another important difference between a *generic* and a *specific* obligation is that, a *specific* obligation, that is, an obligation to deliver a specific thing, is, as a rule, extinguished by a fortuitous event or act of God. Upon the other hand, generic obligations are never extinguished by fortuitous events.

Examples:

- (a) *A* is obliged to give *B* this car. Before delivery, an earthquake destroys completely the car. The obligation to deliver is extinguished.
- (b) *A* is obliged to give *B* a *book*. Since this is a generic thing, even if one particular book is lost, other books may take its place. Hence, the obligation is not extinguished (*genus nunquam perit*).

(7) Two Instances Where a Fortuitous Event Does Not Exempt

The 3rd paragraph of Art. 1165 gives two instances when a fortuitous event does not excuse compliance:

- (a) if the obligor “delays” (This is really *default* or “*mora*.”)
- (b) if the obligor is guilty of BAD FAITH (for having promised to deliver the same thing to two or more persons who do not have the same interest — as when one is *not* the agent merely of the other)

(8) ‘Ordinary Delay’ Distinguished from ‘Default’

Ordinary delay is different from *legal delay* (*default*). The first is merely non-performance at the stipulated time; default

is that delay which amounts to a virtual nonfulfillment of the obligation. (As a rule, to put a debtor in default, there must be a demand for fulfillment, the demand being either judicial or extrajudicial.)

(9) Examples

- (a) *A* is obliged to give *B* his Jaguar car on Dec. 7, 2005. If on said day, *A* does not deliver, he is in *ordinary* delay (not default). If on Dec. 8, 2005, an earthquake destroys the Jaguar car, *A* is not liable because the obligation is extinguished.
- (b) If, however, on Dec. 8, *demand* was made for delivery, *A* would be in *legal* delay (default) and if later, the car is destroyed by a fortuitous event, he would still be liable (in that the obligation to deliver the lost specific thing is converted into a monetary claim for damages). (*See Art. 1165, Civil Code*). However, if the car would have been destroyed *at any rate* even if no demand had been made, the amount of damage would be reduced. (*Art. 2215, No. 4, Civil Code*).

(10) Some Decided Cases and Court Rulings

The phrase “100 kilos of 1st class sugar raised in my plantation” deals with a *generic* thing because of lack of physical segregation. (*Yu Tek v. Gonzales, 29 Phil. 284*).

Yu Tek v. Gonzales 29 Phil. 384

FACTS: *A* obligated himself to sell for a definite price a certain specified quantity of sugar of a given *quality*, without designating a particular lot. **Issue:** In case the sugar is lost by a fortuitous event, who bears the loss prior to delivery, the seller or the buyer?

HELD: In this case, the seller bears the loss because what was to be delivered was *not* a specific thing, but a generic thing. And genus never perishes. Incidentally, the sale here cannot be said to have been already perfected because of the lack of physical segregation from the rest of the sugar.

Roman v. Grimalt
6 Phil. 96

FACTS: A wanted to buy a particular ship from B on condition that B would prove by *papers* that he (B) was the real owner of the ship. Subsequently, the ship was lost by a fortuitous event although the *papers* had *not* yet been produced. *Issue:* Is A required to pay?

HELD: A is not legally bound to pay because there was no *perfected sale* yet, since the condition, namely, the proof of ownership had, at that time of loss, not yet been fulfilled. A was not a buyer; he was only a would-be buyer.

[*NOTE:* Had A already bought the ship — (had the proof of ownership been presented earlier) — he would have been compelled to pay the purchase price even if at the time of loss, the thing had not yet been delivered to him, since after all, the sale would have been already perfected.]

Gutierrez Repide v. Alzelius
39 Phil. 190

FACTS: A bought property from B on installment. When the first installment fell due, A did not pay. His defense was that he did not have money, and he therefore pleaded impossibility of performance. *Issue:* Is A excused from his obligation?

HELD: No. Mere pecuniary inability to pay does not discharge an obligation to pay, nor does it constitute any defense to a decree for specific performance. The stability of commercial transactions requires that the rights of the seller be protected just as effectively as the rights of the buyer.

Art. 1166. The obligation to give a determinate thing includes that of delivering all its accessions and accessories, even though they may not have been mentioned.

COMMENT:

(1) What the Obligation to Give a Determinate Thing Includes

Example:

If I am obliged to deliver a particular car, I must also give the accessories (like the “jack”). If I am obliged to deliver

a piece of land, I must give also the *accessions* (like a building constructed thereon). (This is true even if no mention of them was made in the contract.)

- (2) **Accessories** — those joined to or included with the principal for the latter's better use, perfection, or enjoyment. (*Examples: the keys to a house, the dishes in a restaurant.*)
- (3) **Accessions** — additions to or improvements upon a thing. These include *alluvium* (soil gradually deposited by the current of a river on a river bank) and whatever is *built, planted, or sown* on a person's parcel of land.

(NOTE: Even if the windows of a building have been temporarily removed, they should still be included.)

(4) **Effect of Stipulation**

Of course, if there is a *stipulation* to said effect, accessions and accessories do not have to be included.

Art. 1167. If a person obliged to do something fails to do it, the same shall be executed at his cost.

This same rule shall be observed if he does it in contravention of the tenor of the obligation. Furthermore, it may be decreed that what has been poorly done be undone.

COMMENT:

(1) Positive Personal Obligations

The first sentence of the Article deals with a *positive personal* obligation (TO DO).

(2) Remedies of Creditor if Debtor Fails to Do

- (a) To have the obligation performed (by himself or by another) at debtor's expense (only if *another* can do the performance). (*See Chavez v. Gonzales, L-27454, Apr. 30, 1970.*)
- (b) *Also* — to obtain *damages*. (*Art. 1170, Civil Code*). (Damages alone cannot substitute for performance if owners can

do it; if purely personal or special — as a painting to be done by a reputed artist — only *damages* may be asked, unless substitution is permitted.)

(*NOTE*: Specific performance is *not* a remedy in personal obligations; otherwise, this may amount to involuntary servitude, which as a rule is prohibited under our Constitution.)

[*NOTE*: A party to an agreement to marry who backs out cannot be held liable for the crime of *slander by deed* for then that would be an indirect way of compelling said party to go into a marriage without his or her free consent, and this would contravene the principle in law that what cannot be done directly should NOT be done indirectly; and said party therefore has the right to avoid for himself or herself the evil of going thru a loveless marriage, pursuant to Art. 11, par. 4 of the Revised Penal Code. (*People v. Hernandez, et al.*, 55 O.G., p. 8456, CA).]

Chavez v. Gonzales
L-27454, Apr. 30, 1970

FACTS: A typewriter owner delivered the same to a repairman for repairs agreed upon orally. Despite repeated demands, no work was done thereon. Eventually the repairman returned the machine, unrepaired and worse, several parts were missing, thus the description “cannibalized and unrepaired.” The owner was then constrained to have the typewriter repaired in another shop. Owner now claims damages from the first repairman (for the cost of the repairs and the cost of the missing parts). Defendant repairman, however, alleges that owner should have first filed a petition for the court to fix the period within which the job of repairing was to be finished.

ISSUES:

- (a) Can the defendant be held liable for damages?
- (b) How about the failure of the owner to first ask the court for the fixing of the period?

HELD:

- (a) Yes, the defendant can be held for damages and this would include the cost of labor and needed materials, as well as the value of the missing parts. According to Art. 1167 — “If a person obliged to do something fails to do it, the same shall be executed at his cost. The same rule shall be observed if he does it in contravention of the tenor of the obligation.”
- (b) The failure of the owner of the computer notebook to first ask the court for a fixing of the period within which the repairs were to be done is of no significance. In view of his returning of the machine, the time for compliance may be deemed to have already expired. There is, therefore, no more period to be fixed, there already being a breach of contract by *non-performance*. Said non-performance may be said to have been impliedly admitted when the notebook was returned unrepaid and with some of its essential parts missing.

(3) When a Thing May Be Ordered Undone

- (a) if made poorly (*Art. 1167*) (Here *performance* by another and *damages* may be demanded).
- (b) if the obligation is a *negative* one (provided the *undoing* is possible).

Art. 1168. When the obligation consists in not doing, and the obligor does what has been forbidden him, it shall also be undone at his expense.

COMMENT:**Negative Personal Obligations**

- (a) This Article refers to a *negative* personal obligation.
- (b) As a rule, the remedy is the *undoing* of the prohibited thing *plus damages*. (*See Art. 1170, Civil Code*).

Art. 1169. Those obliged to deliver or to do something incur in delay from the time the obligee judicially or extrajudicially demands from them the fulfillment of their obligation.

However, the demand by the creditor shall not be necessary in order that delay may exist:

(1) When the obligation or the law expressly so declares; or

(2) When from the nature and the circumstances of the obligation it appears that the designation of the time when the thing is to be delivered or the service is to be rendered was a controlling motive for the establishment of the contract; or

(3) When demand would be useless, as when the obligor has rendered it beyond his power to perform.

In reciprocal obligations, neither party incurs in delay if the other does not comply or is not ready to comply in a proper manner with what is incumbent upon him. From the moment one of the parties fulfills his obligation, delay by the other begins.

COMMENT:

(1) Default or Mora

Although Art. 1169 uses the words “in delay,” these should be translated to mean *default (MORA)*.

(2) Necessity in General of Demand

To put a debtor in *default*, as a rule, DEMAND is needed. The demand may be *judicial*, as when a complaint for specific performance is filed; or *extrajudicial*, without court proceedings.

(3) When Demand Is Not Needed to Put Debtor in Default

(a) When the *law* so provides. (*Example:* Taxes should be paid within a definite period, otherwise penalties are imposed without need of demand for payment.)

- (b) When the *obligation* expressly so provides.

[NOTE: The mere fixing of the period is not enough; there must be a *provision* that if payment is not made when due, *default* or liability for damages or interests automatically arises. (See *De la Rosa v. Bank of P.I.*, 51 Phil. 926).]

(NOTE: The contrary ruling in *Siulong and Co. v. Ylagan*, 43 Phil. 393, is wrong.)

- (c) When time is of the essence of the contract (or when the fixing of the time was the controlling motive for the establishment of the contract).

Examples: The making of a wedding dress, if the wedding is scheduled at the time the dress is due; agricultural contracts where implements are needed at a particular time; the selling of land with payment at specified time, so that the seller could pay off certain debts that were due on said date (*Abella v. Francisco*, 55 Phil. 447); money needed to finance mining installations if said installations had to be made on a certain date. (*Hanlon v. Hausserman*, 40 Phil. 796).

[NOTE: It is not essential for the contract to categorically state that time is of the essence; the *intent* is sufficient as long as this is implied. (*Hanlon v. Hausserman*, *Supra.*)]

- (d) When demand would be *useless*, as when the obligor has rendered it beyond his power to perform. (*Examples:* When before the maturity, the seller has *disposed* of it in favor of another, or has destroyed the subject matter, or is hiding.)
- (e) When the obligor has expressly acknowledged that he really is in default (But it should be noted that his *mere asking* for extension of time is not an express acknowledgment of the existence of default on his part). (See 3 *Salvat* 64).

(4) Different Kinds of Mora

- (a) *mora solvendi* (default on the part of the debtor)

- 1) *mora solvendi ex re* (debtor's default in *real obligations*)
- 2) *mora solvendi ex persona* (debtor's default in *personal obligations*)
- (b) *mora accipiendi* (default on the part of the *creditor*)
- (c) *compensatio morae* (when in a *reciprocal obligation both parties* are in default; here it is as if *neither* is in default).

(5) Mora Solvendi

- (a) There is no *mora solvendi* in negative obligations (one cannot be *late* in *not doing* or *giving*).
- (b) There is no *mora* in *natural* obligations.
- (c) Requisites for *mora solvendi*:
 - 1) The obligation must be due, enforceable, and already liquidated or determinate in amount. (*TS, Mar. 15, 1926*).
 - 2) There must be non-performance.
 - 3) There must be a demand, unless the demand is not required (as already discussed). (When demand is needed, proof of it must be shown by the creditor). (*8 Manresa 61*).

[NOTE: A mere reminder, like "This is to remind you that your next installment falls due on Jan. 7, 2005," is *not* a demand because for all that we know, lateness may still be tolerated by the creditor. (*2 Castan 528*).]

- 4) The demand must be for the obligation that is due (and not for another obligation, nor one with a bigger amount, except in certain instances, considering all the circumstances). (*See TS, Jan. 1910*).
- (d) *Effects of Mora Solvendi*
 - 1) If the debtor is in default, he may be liable for interest or damages.

- 2) He may also have to bear the risk of loss.

(In both cases, it is, however, essential that his being in default is attributable to his own fault.)

- 3) He is liable even for a fortuitous event (*Art. 1165, Civil Code*), although damages here may be *mitigated* if he can prove that even if he had not been in default, loss would have occurred just the same. (*Art. 2215, Civil Code*).

- (e) In a purchase by installments, the contract may provide for an “acceleration clause” (a clause which would make *all* installments due, upon default in *one* installment). *Default* in the payment of one installment does not mean default in the *whole* amount. If there is an acceleration clause, all that happens will be that the *whole* amount becomes due. And demand is still needed to put the debtor in default. (*See Queblar v. Garduno & Martinez, 62 Phil. 897*).

(6) Mora Accipiendi

- (a) The creditor is guilty of default when he *unjustifiably* refuses to accept payment or performance at the time said payment or performance can be done. Some *justifiable* reasons for refusal to accept may be that the payor has no legal capacity or that there is an offer to pay an obligation *other* than what has been agreed upon.
- (b) If an obligation arises *ex delicto* (as the result of a crime), the debtor-criminal is responsible for loss, even though this be through a fortuitous event, unless the creditor is in *mora accipiendi*. The law says:

“When the debt of a thing certain and determinate proceeds from a criminal offense, the debtor shall not be exempted from the payment of its price, whatever may be the cause for the loss, unless the thing having been offered by him to the person who should receive it, the latter refused without justification to accept it.” (*Art. 1268, Civil Code*).

[NOTE: What should the criminal do if the creditor is in *mora accipiendi*?

ANS.: He must either:

- 1) consign it in court (expenses chargeable to creditor);
 - 2) or keep it himself (here he should still exercise diligence and care, but this time, he would not be liable for loss due to a fortuitous event). (*See 2 Manresa 361*). (Loss thru robbery with violence is a fortuitous event provided that the violence or intimidation was irresistible or grave.)]
- (c) The improper refusal of the lessor (creditor) to accept the rents tendered by the lessee places said lessor in default (*mora*) and he must shoulder the subsequent accidental loss of the premises leased. The *mora accipiendi* of said lessor is *not* cured by the lessee's failure to make consignment of the rejected payments, but the lessee remains obligated to pay the amounts he had tendered but did not deposit in court. (*Vda. de Villaruel, et al. v. Manila Motor Co. & Colonaires, L-10394, Dec. 3, 1958*).

(7) Reciprocal Obligations

- (a) Reciprocal obligations depend upon each other for performance. (*Example: In a sale the buyer must PAY, and the seller must DELIVER.*)
- (b) Here performance may be set on *different dates*.
[Example – delivery on Dec. 9, 2005; and payment on Dec. 13, 2005. To put the seller in default, demand as a rule must be made. Delivery, upon the other hand, does not put the buyer in default, till after demand, unless demand is not required. This is because, in the example given, different periods for performance were given. (See 8 Manresa 63-64).]
- (c) If the performance is *not set* on different dates, either by the law, contract, or custom, it is understood that performance must be *simultaneous*. Hence, one party cannot demand performance by the other, if the former himself cannot perform. And when neither has performed, there is *compensatio morae* (*default* on the part of both; so it is as if no one is in default). If one party performs, and the

other does not, the latter would be in default. (*See Gutierrez Hermanos v. Oria Hermanos*, 30 Phil. 491).

**Mariano Rodriguez, et al. v.
Porfirio Belgica, et al.
L-10801, Feb. 28, 1961**

FACTS: Rodriguez and Belgica were co-owners of land in the proportion of 86% and 14%, respectively. Belgica owed Rodriguez P30,000. To enable Belgica to pay it, it was mutually agreed that Rodriguez would grant authority to Belgica to sell or mortgage within 70 days 36% of the land, so that Belgica would be able to raise the money for payment of the loan. *Issue:* From what time should the 70-day period begin to run?

HELD: The period commences from the time Rodriguez grants said authority to Belgica. For this partakes of a reciprocal obligation — the granting of the authority and the payment of the loan. Without such authority, it was difficult, if not impossible, for Belgica to obtain the needed P30,000. This was because he owned only 14% of the land.

(8) When Damages or Interest May Be Lost

A creditor entitled to damages or interest because of *MORA* may lose the same —

- (a) If the *principal* obligation is allowed to lapse by prescription;
- (b) If the *damages* or *interest* are allowed to prescribe;
- (c) If the damages or interest are *condoned* (waived or remitted).

(9) Some Decided Cases

**Compania General de Tabacos v. Araza
7 Phil. 455**

If a debt is not paid at the stipulated period, interest (as damages) should be charged not from the date of maturity, but

from the time the *judicial action* is filed, in case *no* extrajudicial demand was made.

Price, Inc. v. Rilloraza, et al.

L-82053, May 25, 1955

FACTS: A tenant leased a land on the landlord's promise that the latter would make improvements on the property leased. When the landlord did not make the improvements, the tenant *sued for specific performance*, that is, to make the landlord do the improvements. Three days later, the landlord sued for unlawful detainer for non-payment of rent.

HELD: This is reciprocal obligation, and since no improvements have yet been made, the landlord cannot demand rents and the tenant is not yet in default, and therefore unlawful detainer *cannot prosper*.

Queblar v. Garduno and Martinez

62 Phil. 879

FACTS: A debt was payable in installments. It was also agreed that if any installment was not paid on time, the *whole* debt would *mature* (acceleration clause). The debtor did not pay one installment on time. After some time, because the debtor did not pay the whole debt, the creditor brought this action. *Issue:* From what time was the debtor in default, from the time the installment was not paid at the stipulated date, or from the time the action was filed? (This was essential to determine the computation of interest.)

HELD: From the time demand was made by the filing of the action, there having been no previous extrajudicial demand. Hence, interest as damages should begin only from that date. *Reason:* It is true that there was an acceleration clause, and this is why the creditor is now entitled to recover the whole debt. But the contract *did not say* that failure to pay one installment would put the debtor in default. Hence, demand was still essential.

Causing v. Bencer

37 Phil. 417

FACTS: Plaintiff *A*, acting as guardian of some minors, agreed to sell to defendant *B* a parcel of land owned in common

by her and her wards on the condition that *A* would first obtain judicial approval with regard to the wards' share. *B* immediately paid part of the purchase price and proceeded to occupy the land. Although judicial approval had been obtained, *A* did *not* execute a deed sufficient to convey the whole parcel. Instead, she asked for the balance of the purchase price. Failing in this, she charged *B* with *default* and now wants to rescind or cancel the contract on the ground of non-payment.

HELD: In reciprocal obligations like this, default on the part of one begins only from the moment the other party fulfills what is incumbent upon him or her. Since the plaintiff Rufina Causing has not yet executed a deed sufficient to pass the whole estate, she is not now in a position to rescind the contract.

**De la Rosa v. Bank of P.I.
51 Phil. 926**

Even if prizes are not distributed on the date set in the rules of a contest, the sponsoring company is not in default till after a demand is made, for ordinarily one does not enter a contest just to get the prize on the *date specified*.

**Malayan Insurance Co., Inc. v. CA
GR 59919, Nov. 25, 1986**

A debtor who incurs in delay or default is liable for damages plus interest, generally from extrajudicial or judicial demand in the form of interest.

**Spouses Puerto v. CA
GR 138210, Jun. 13, 2002**

FACTS: Petitioners committed a breach of obligation in their refusal to pay a sum of money loaned. **Issue:** Owing to said breach, may compensatory damages be awarded?

HELD: Yes, by way if an interest is the amount of 12% *per annum*, to be computed from default, *i.e.*, from judicial or extrajudicial demand in accordance with Art. 1169.

Such interest is not due to stipulation Rather it is due to the general provision of law that in obligation to pay money;

where the debtor incurs in delay, he has to pay interest by way of damages. (*See Eastern Shipping Lines, Inc. v. CA, 234 SCRA 78 [1994]*).

(10) Imposition of Interest

Bangko Sentral ng Pilipinas v. Santamaria GR 139885, Jan. 13, 2003

In *Eastern Shipping Lines, Inc. v. Court of Appeals* (234 SCRA 78 [1994]), the following guidelines have been laid down in the imposition of interest:

1. When an obligation, not constituting a loan or forbearance of money, is breached, an interest on the amount of damages awarded may be imposed at the court's discretion with 6% rate *per annum*. No interest, however, shall be adjudged on unliquidated claims or damages except when or until demand can be established with reasonable certainty. In the event that demand is established with reasonable certainty, interest shall begin to run from the time claim is made judicially or extrajudicially. (*Art. 1169, Civil Code*). However, when such certainty cannot be so reasonably established at the time demand is made, interest shall begin to run only from the date the court judgment is made (at which time, quantification of damages may be deemed to have been reasonably ascertained). Actual base for computation of legal interest shall, in any case, be on amount finally adjudged.

2. When court judgment awarding a sum of money becomes final and executory, the rate of legal interest, whether the case falls under par. 1 or par. 2 above, shall be 12% *per annum* from such finality until its satisfaction, this *interim* period being deemed to be by then an equivalent to forbearance of credit.

Since the case at bar does not involve any obligation arising from loan or forbearance of money, then interest should be imposed as follows:

a. On the first billing for P450,604.96 – 6% *per annum* computed from the date of demand on Feb. 23, 1996 while an interest of 12% *per annum* shall be imposed

on such amount from finality of decision until payment thereof.

b. On the second billing for P62,451.05 – 6% *per annum* computed from date of demand on Sept. 10, 1996 while an interest of 12% *per annum* shall be imposed on such amount from finality of decision until payment thereof.

c. On the P108,610.52 for services rendered from Apr. 10, 1996 to Jul. 31, 1996 – 6% *per annum* computed from date of decision of IAC (Intermediate Appellate Court) on Feb. 20, 1998 while interest of 12% *per annum* shall be imposed on such amount from finality of decision until payment thereof.

Art. 1170. Those who in the performance of their obligation are guilty of fraud, negligence, or delay and those who in any manner contravene the tenor thereof, are liable for damages.

COMMENT:

(1) Grounds for Liability in the Performance of Obligations

- (a) fraud (deceit or *dolo*) (intentional evasion of fulfillment).
- (b) negligence (fault or *culpa*). (*See Art. 1173, Civil Code*).
- (c) default (or *mora*) (if *imputable* to the *debtor*).
- (d) violation of the terms of the obligation (*violatio*) (*unless excused in proper cases by fortuitous events*).

[NOTE: The following do not excuse fulfillment:

- 1) increase in cost of performance. (*U.S. v. Varadero de la Quinta, 40 Phil. 48*).
- 2) poverty. (*Repide v. Alzelius, 39 Phil. 190*).
- 3) war between the subject of a neutral country and the subject of a country at war, as long as substantial compliance can still be done. (*Int. Harvester Co. v. Hamburg-American Line, 42 Phil. 854*).

BUT chaos in Manila in February 1945 during the liberation period can be considered a sufficient excuse for *not paying on time* the obligations maturing that month. (*Manalac v. Garcia*, 76 Phil. 216).]

(NOTE: In *McConnel, et al. v. Court of Appeals*, L-10510, Mar. 17, 1961, it was held that even individual stockholders may be held liable for corporate obligations wherever circumstances show that the corporate entity is being used as an *alter ego* or business conduit for the sole benefit of the stockholders or else to defeat public convenience, justify wrong, protect fraud, or defend crime. The fiction of separate personality cannot be used to shield fraud. In *Rivera, et al. v. Colago, et al.*, L-12323, Feb. 24, 1961, the Court held that the government officials concerned are duty bound to implement the provisions of the minimum wage law by appropriating the necessary amounts for the payment of the increased salaries of the employees. Such appropriation cannot be left at their discretion nor can said official avoid compliance with their duty by invoking lack of funds. While ordinarily there should have been a *certification* of the availability of funds, this is NOT needed here, for *other employees* had already been *paid* prior to the commencement of this case. Since the duty is mandatory, *MANDAMUS* can properly issue.)

Gatchalian v. Arlegui
75 SCRA 234

If a losing party litigant disobeys a writ of possession addressed by the court not to him but to a sheriff, said disobedient litigant is not, by that fact of disobedience alone, guilty of contempt of court.

(2) Examples of Violation of a Contract (“In Any Manner Contravene the Tenor Thereof”)

- (a) When a landlord fails to maintain a tenant in the legal possession of the leased land (because the landlord was *not* its owner, and the owner now wants to occupy the land). (*De*

la Cruz v. Seminary of Manila, 18 Phil. 330). Similarly, if a lessee or tenant does *not* pay the stipulated rents despite oral and written demands by the lessor or landlord, the latter is entitled to a judgment for ejectment and recovery of damages suffered. (*De los Santos v. Gorospe, et al.*, L-12023, Apr. 29, 1959).

- (b) When a person who *agreed* to supply some cinematographic films cannot do so because of his fault. (*Acme Films v. Theaters Supply*, 63 Phil. 657).
- (c) When a common carrier fails to take its passengers to their destination. (*Gutierrez v. Gutierrez*, 56 Phil. 177). While overcrowding in a bus is not negligence *per se*, still the bus is under a duty to exercise a high degree of care to protect its passengers from dangers likely to arise therefrom. Thus, if as a *result of overcrowding* a passenger falls, and an *attempted rescue by a fellow passenger* is frustrated because the bus driver *immediately* starts the vehicle, the bus company can be held liable.
- (d) If a taxi passenger is intentionally killed by the driver, an action for damages can be brought against both the driver and the taxi company (or operator) under Art. 1759 of the Civil Code. The driver, true, did *not* act within the scope of his authority, but then a carrier (like the company) must afford full protection. The carrier delegates to the driver (its servant) the duty to protect the passengers with utmost care. The company thus bears the risk of *wrongful* or *negligent* acts of its employees since it has power to select and remove. (*Maranan v. Perez*, GR L-22272, Jun. 26, 1967).
- (e) If a person enters into a contract where he has to meet certain bank requirements, but is unable to meet said requirements, he is liable for breach of contract, if he knew from the very beginning that said requirements could not be complied with by him. (*Arrieta v. NARIC*, L-15645, Jan. 31, 1964).

Santiago v. Gonzales
79 SCRA 494

FACTS: Regarding a contract with a construction firm, the owner wrote the firm that he intended to cancel

the contract, whereupon the firm stopped construction work for alleged non-payment of fees at the proper time. Is the firm liable?

HELD: No, for after all, the adverse party had already informed the firm of the former's intention to cancel or rescind the contract.

(3) Liability for Damages

Those liable under Art. 1170 should pay *damages*, but generally *only* if aside from the *breach of contract*, prejudice or damage was caused. (*Berg v. Teus*, GR L-6453, Oct. 30, 1964).

Buayan Cattle Co., Inc. v. Quintillan L-26970, Mar. 19, 1984

Even if a lease agreement (such as the Pasture Lease Agreement) expires, the claims for damages that arose during the existence of the lease continue to subsist. We cannot regard said claims as having become moot and academic.

Bobis v. Prov. Sheriff of Camarines Norte GR 29838, Mar. 18, 1983

If a sheriff follows the *literal* terms of a writ of execution, he is *not* liable for damages.

Phil. Long Distance Telephone Co. v. National Labor Relations Commission GR 58004, May 30, 1983

If an employee has been laid off for more than four (4) years but was *not* in the meantime prohibited from looking for another employment, his backwages may be limited or reduced. One must minimize damages that have been inflicted upon him. He should have looked for work in the meantime.

(4) Kinds of Damages (Keyword — MENTAL)

- (a) MORAL — (for mental and physical anguish)

[NOTE: The anguish, worry and anxiety of a defendant in a litigation that was *not maliciously* litigated cannot be considered as the moral damages contemplated in the law. (*Ramos v. Ramos*, L-19872, Dec. 3, 1974).]

**Compania Maritima v.
Allied Free Workers' Union
77 SCRA 24**

Moral damages cannot be recovered unless proved. A mere prayer for the same is not sufficient.

- (b) EXEMPLARY — (*corrective* or to set an example)
- (c) NOMINAL — (to vindicate a *right* — when no other kind of damages may be recovered)

(NOTE: In *Ventanilla v. Centeno*, L-4333, Jan. 28, 1961, it was held that nominal damages are NOT for indemnification of the loss suffered, but for the vindication of a right violated, the assessment of which is left to the *discretion* of the court.)

- (d) TEMPERATE — (when the exact amount of damages cannot be determined)
- (e) ACTUAL — (*actual losses* as well as *unrealized profit*)
- (f) LIQUIDATED — (predetermined beforehand — by agreement)

Damages should be paid by those responsible for them. (*Enciso v. Nacoco*, [C.A.] 46 O.G. 4321).

**Travellers' Indemnity Co.
v. Barber Steamship Lines, Inc.
77 SCRA 10**

One who claims damages because of damage to goods under the Bureau of Customs arrastre services should file the claim with the Commission on Audit instead of filing the case with the regular courts. The Bureau of Customs, in operating the arrastre service, does so in connection with a principal government function. As such, neither the Bureau nor the Republic may be sued. Thus, the remedy is with the Commission on Audit under Act 3083 and CA 327.

**Bagumbayan Corporation v.
Intermediate Appellate Court & Lelisa Seña
GR 66274, Sept. 30, 1984**

If in a restaurant, a waiter falls on a lady customer, spills drinks on her, and causes her to go to the comfort room and take off her clothes and remain naked, without the restaurant offering her any apology, she is entitled to ACTUAL DAMAGES, but *not* to MORAL DAMAGES, for the mental anguish and embarrassment in this case cannot be considered as falling within the scope of Art. 2217 of the Civil Code.

(5) Damages in Monetary Obligations

In *monetary* obligations, *indemnity* for damages consists of:

- (a) that agreed upon;
- (b) in the absence of agreement, the legal rate of interest. (*Art. 2209, Civil Code; Quiros v. Tan-Guinlay, 5 Phil. 675*). If a contract of simple loan stipulates the time when interest will be counted, said stipulated time controls. (*Piczon v. Piczon, L-29139, Nov. 15, 1974*).

(6) Remedies of Professors and Teachers

Under the Civil Code, there is no provision governing the relative rights of a teacher or professor, and those of the school that desires to dispense with the services of the former. However, the remedy can be found today in Republic Act 1952 (the “*mesada*” or “one-month pay” rule) as amended by RA 1787. (*Mapua Institute of Technology v. Manalo, L-14885, May 31, 1960*).

(7) Creditor of a Judge

**Taboada v. Cabrera
78 SCRA 235**

If a creditor of a judge wants to collect a sum of money from the latter, the creditor should not file the civil complaint with the Supreme Court.

Art. 1171. Responsibility arising from fraud is demandable in all obligations. Any waiver of an action for future fraud is void.

COMMENT:

(1) Liability for Fraud or Dolo

- (a) According to time of commission, fraud may be *past* or *future* (liability for past fraud may be waived; this is not so for future fraud).
- (b) According to meaning, fraud may be classified as follows:
 - 1) fraud in *obtaining consent* (may be *causal* or merely *incidental*)
 - 2) fraud in *performing* a contract (*inaccurately* referred to by some as *incidental* fraud). Fraud here may be either:
 - a) *dolo causante* (causal fraud)
 - b) *dolo incidente* (incidental fraud)

(2) While *dolo causante* is so important a fraud that vitiates consent (allowing therefore annulment), *dolo incidente* is not important

**Bangoy v. Phil.-American
Life Insurance Company
CA-GR 55652-R**

If an insured commits a material misrepresentation, fraud, or concealment in his insurance application, the insurance contract cannot be regarded as valid. (*Note: the annulment case must be within two years from the perfection of the contract.*) If the truth had been told, there would have been no contract, or one would have been made with a much higher premium (considering the true state of health of the insured).

(*NOTE: The fraud here is important, and is referred to as DOLO CAUSANTE.*)

(3) Tax Evasion

Tax evasion (as distinguished from *tax avoidance*) connotes fraud thru the use of pretenses and forbidden devices to lessen or defeat taxes. However, a taxpayer has the legal right to *decrease* the amount of what otherwise would be his taxes or altogether *avoid* them by means which the law permits. He does *not* incur fraud thereby even if the tax paid is thereafter found to be insufficient. (*Yutivo & Sons Hardware Co. v. Court of Tax Appeals, et al., L-13203, Jan. 28, 1961*).

Art. 1172. Responsibility arising from negligence in the performance of every kind of obligation is also demandable, but such liability may be regulated by the courts, according to the circumstances.

COMMENT:

(1) Fraud Distinguished from Negligence

<i>DOLO</i>	<i>CULPA</i>
(a) There is a DELIBERATE intention to cause damage or prejudice.	(a) Although <i>voluntary</i> (that is, <i>not done thru force</i>) still there is NO DELIBERATE intention to cause damage.
(b) Liability arising from <i>dolo</i> cannot be mitigated or reduced by the courts.	(b) Liability due to negligence may be reduced in certain cases.
(c) Waiver of an action to enforce liability due to <i>future</i> fraud is void.	(c) Waiver of an action to enforce liability due to <i>future culpa</i> may in a certain sense be allowed.

**Laurel v. Abroga
483 SCRA 243 (2006)**

Among the prohibited acts enumerated in Sec. 9 of RA No. 8484 or “Access Devices Regulation Act of 1998,” are:

1. the acts of obtaining money or anything of value thru the use of an access device with intent to defraud or intent to gain and fleeing after; and
2. of effecting transactions with one or more access devices issued to another person or persons to receive payment or any other thing of value.

Under Sec. 11 of the law, conspiracy to commit access devices fraud is a crime.

(2) Stipulations Regarding Negligence (Future Negligence)

- (a) *Gross* negligence can never be excused in advance for this would be contrary to public policy.
- (b) *Simple* negligence may in certain cases be *excused* or *mitigated*.
- (c) Three (3) usual kinds of stipulation in a *bill of lading* (contract for the shipping or transporting of goods):
 - 1) The first one exempts the carrier from *all* liabilities for loss or damage occasioned by its own negligence. (This is against public policy and is void). (*See Art. 1745, Nos. 2 and 3, Civil Code*).

Example of this invalid stipulation: “No matter how negligent the carrier will be, it will not be responsible for the damage caused.”

- 2) The second one *limits* the liability to an *agreed valuation*, no matter how much damage is caused. (In other words, no matter how much damage is caused, the value that can be recovered is the same. This is also VOID since a wealthy company would be able to afford being negligent.)

Example: “No matter how negligent the carrier will be, and regardless of the value of the goods, it will pay damages only up to P100.00.” (Since this is *void*, the *actual damage* may still be recovered.)

- 3) The third one *limits* the liability to an *agreed value* UNLESS the shipper declares a *higher* value and pays

a higher rate of freight. (This is valid and enforceable, as a rule). (*Freixas Co. v. Pacific Mail Steamship Co.*, 42 Phil. 198 and *Heacock v. Macondray and Co.*, 42 Phil. 205). (See *American President Lines, Ltd. v. Richard A. Klepper, et al.*, L-15671, Nov. 29, 1960, where the Supreme Court awarded only the amount stated in the bill of lading — P500 instead of P6,729.50 — the amount of actual damages. Klepper cannot elude its provisions simply because they prejudice him, and take advantage of those that are beneficial.)

Example: “No matter how negligent the carrier may be, it will pay damages only up to P100, BUT, if the shipper declares that the value of his goods is more than P100, and pays a *higher rate of freight*, then damages may be recovered to the extent of the value declared.” [This is ordinarily valid since it rewards honesty; but sometimes the amount will be increased if the value of the goods be considerably higher than the price declared as when silk cases worth P3,500 each were lost but the carrier only wanted to pay P300 each because the shipper *failed to declare* a value higher than P300. Here, the court said that to give only P300 for each would be unconscionable, considering the circumstances. (See *Ysmael and Co. v. Barretto*, 51 Phil. 90).]

**Phoenix Assurance Co. v.
Macondray & Co., Inc.
L-25048, May 13, 1975**

FACTS: A shipper in South Carolina sent to a carrier ship (S.S. Fernbank) for eventual delivery to Floro Spinning Mills in Manila a shipment of one box and one carton containing textile machinery spare parts worth \$4,183.74. The value was, however, NOT DECLARED and so the usual charge of \$46.20 was made for the freightage. In the bill of lading was printed a stipulation to the effect that in case of loss or damage, the carrier's liability was fixed only at \$500, unless a higher value is declared in the bill of lading and extra freightage paid, if required (this time the

freightage would be on a value or *ad valorem* basis). The shipment was insured for \$5,450 with Phoenix Assurance Company of New York. On arrival, it was discovered that a portion of the shipment had been damaged (to the extent of \$1,512.78). The Floro Spinning Mills sued both carrier and insurance. The Phoenix Assurance Company paid the equivalent of \$1,512.78. In turn, the insurance company asked reimbursement from the carrier. The carrier, however, said that it was willing to answer for only \$500 as stated in the bill of lading. *Issue*: How much reimbursement must be given — \$500 or \$1,512.78?

HELD: Reimbursement should be for only \$500 in view of the stipulation in the bill of lading, a stipulation sanctioned by our jurisprudence. (*Heacock v. Macondray and Co.*, 42 Phil. 205, etc. and Arts. 1749 and 1750, Civil Code). Be it noted that no value higher than \$500 had been declared. (Note the \$500 should be given in the conversion rate that will exist at the time *satisfaction* of the judgment is actually made.)

(3) Rule in Contracts of Adhesion

There is greater freedom to stipulate on negligence if the parties are on an equal plane; not where they are obviously in unequal positions (CONTRACTS OF ADHESION) such as in the case of *employment or transportation* contracts. (*See Art. 1745, Civil Code; 2 Castan 532-533*). Moreover, stipulations on negligence must be strictly construed against the party situated in a higher or more advantageous position. (*See MRR v. Compania Transatlantica*, 38 Phil. 875).

Delgado Brothers, Inc. v. Court of Appeals, et al. **L-15654, Dec. 29, 1960**

FACTS: Delgado Brothers, Inc. were the official unloaders of the cargoes shipped on the American President Lines. In its contract with the latter, a clause reads: “We, the American President Lines, hereby assume full responsibility and liability for damages to cargoes, ship, or otherwise arising from the use of the unloading crane of the Delgado Brothers, Inc. and we will *not* hold said Company liable or responsible in any way thereof.”

One Richard Klepper shipped thru the American President Lines a lift van containing certain personal effects. While the van was being unloaded by the gantry crane operated by the Delgado Brothers, it fell on the pier, breaking the goods inside. The shipping company was ordered to pay for the damages. *Issue:* Is the Delgado Bros., Inc. required to reimburse the carrier?

HELD: No, because of the *exemption* in the contract from liability on the part of the Delgado Bros., Inc. The exemption is CLEAR.

NOTE: In *Warner, Barnes & Co., Ltd. v. Yasay (L-12984, July 26, 1960)*, the Supreme Court held that while the debtor was negligent in paying for the cost of the fertilizer which he had purchased on credit prior to the last war, still he should *not* be charged *interest* during the war years, since he was in *good faith*, and since also the creditor was a British company and therefore an *enemy* of the Japanese occupation forces.

(4) Kinds of Culpa Classified According to the Source of the Obligation

- (a) *culpa contractual* (contractual negligence — or that which results in a breach of a contract).
- (b) *culpa aquiliana* (civil negligence or tort or *quasi-delict*).
- (c) *culpa criminal* (criminal negligence — or that which results in the commission of a *crime* or a *delict*).

(5) Distinctions Re the Three Kinds of Culpa

CULPA CONTRACTUAL	CULPA AQUILIANA	CULPA CRIMINAL
(a) Negligence is merely incidental, incident to the performance of an obligation already existing because of a contract. (<i>Rakes</i>	(a) Negligence here is direct, substantive, and independent. (<i>Rakes v. Atlantic Gulf & Pacific Co., 7 Phil. 395</i>).	(a) Negligence here is direct, substantive, and independent of a contract.

<i>v. Atlantic Gulf & Pac. Co., 7 Phil. 395).</i>		
(b) There is a pre-existing obligation (a contract, either express or implied). (<i>Rakes Case</i>).	(b) No pre-existing obligation (except of course the duty to be careful in all human actuations). (<i>Rakes Case</i>).	(b) No pre-existing obligation (except the duty never to harm others).
(c) Proof needed — preponderance of evidence. (<i>Barredo v. Garcia, I.O.G. No. 6, p. 191</i>).	(c) Proof needed — preponderance of evidence. (<i>Barredo v. Garcia, I.O.G. No. 6, p. 191</i>).	(c) Proof needed in a crime — proof of guilt beyond reasonable doubt. (<i>Barredo v. Garcia</i>).
(d) Defense of “good father of a family” in the selection and supervision of employees is not a proper complete defense in <i>culpa contractual</i> (though this may MITIGATE damages). (<i>Cangco v. Manila Railroad Co., 38 Phil. 769 and De Guia v. Meralco, 40 Phil. 760</i>). Here we follow the rule of RESPONDEAT SUPERIOR or COMMAND RESPONSIBILITY or the MASTER AND SERVANT RULE).	(d) Defense of “good father, etc,” is a proper and complete defense (insofar as employers or guardians are concerned) in <i>culpa acquiliana</i> . (<i>Cangco and De Guia Cases</i>).	(d) This is not a proper defense in <i>culpa criminal</i> . Here the employee’s guilt is <i>automatically</i> the employer’s civil guilt, if the former is insolvent. (<i>See M. Luisa Martinez v. Barredo</i>).
(e) As long as it is proved that <i>there</i> was a <i>contract</i> ,	(e) Ordinarily, the victim has to prove the negligence of the	(e) Accused is presumed innocent until the con-

<i>and that it was not carried out, it is presumed that the debtor is at fault, and it is his duty to prove that there was no negligence in carrying out the terms of the contract. (Cangco Case; 8 Manresa 71).</i>	defendant. This is because his action is based on alleged negligence on the part of the defendant. <i>(Cangco Case and 8 Manresa 71).</i>	trary is proved, so prosecution has the burden of proving the negligence of the accused.
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(6) Some Illustrative Examples

(a) CULPA CONTRACTUAL

A passenger in a taxi was hurt because of the taxi driver's negligence.

- 1) This is *culpa contractual* (there was a contract of carriage between the passenger and the owner of the taxicab company). This is true even if the passenger *had not yet paid*; true also, even if he had no money to pay; true also even if the accident occurred as the passenger was boarding the taxi. *(See Lasam v. Smith, 45 Phil. 657).*
- 2) The hurt passenger may bring a civil case of *culpa contractual* (for breach of the contract of carriage) *against* the owner of the taxicab company, and not against the driver, because the contract is *between* the passenger and the owner, and not between the passenger and the driver, who merely represents the owner. Hence, properly, only the owner should be the defendant (without prejudice to his right to reimbursement from his driver). *(Sudo v. Zamora, [C.A.] 37 O.G. 962 and Enciso v. Nacoco, [C.A.] 46 O.G. 962 give the correct rule, and not Gutierrez v. Gutierrez, 56 Phil. 177).*
- 3) If the owner can prove that he exercised due diligence in the *selection* and *supervision* of the driver, said

owner is still responsible because of “*respondeat superior*” or the master-servant rule (the negligence of the servant is the negligence of the master). However, this “diligence” of the owner makes him a debtor in *good faith* and the damages would be mitigated. (See *Manila Railroad Co. v. Compania Transatlantica*, 38 Phil. 875; *Cangco v. Manila Railroad Co.*, 38 Phil. 769 and *De Guia v. Manila Electric Co.*, 40 Phil. 760).

- 4) All that the passenger must prove is the existence of the contract of carriage, and the fact that there was a breach because he did not arrive at his destination unhurt. If the company wants to escape liability, it is its duty to prove that the driver was really *careful*; otherwise, the presumption of the driver’s negligence remains. (See *Cangco v. Manila Railroad Co.*, 38 Phil. 769, where a train passenger, on alighting from a train, was hurt when he fell on sacks of watermelons carelessly strewn about; see also 8 *Manresa* 71).

Antonio V. Roque v. Bienvenido P. Buan
L-22459, Oct. 31, 1967

FACTS: In a bus bound for Pampanga, a passenger (Antonio V. Roque) was injured as a result of the driver’s violent swerving to the right to avoid a head-on collision with another vehicle. **Issue:** Is the bus company presumed negligent?

HELD: Yes, the bus or common carrier is presumed negligent in case of death or physical injuries to passengers unless it proves the exercise of extraordinary diligence. Indeed when the action is based on a contract of carriage, and not of tort, the court need not make an express finding of fault or negligence on the part of the carrier, for its obligation is to transport the passenger safely. (See *Dy Sy v. Malate Taxicab, et al.*, L-8937, Nov. 29, 1957).

- 5) If the taxi contained *defective parts*, this is also negligence on the part of the company. The company cannot claim *force majeure* as an excuse here. (*Lasam v. Smith*, 45 Phil. 657).

San Pedro Bus Line v. Navarro
L-6291, Apr. 29, 1954

FACTS: A passenger on a truck was hurt, but in a *criminal case* against the driver, said driver was acquitted. The victim now sues the owner of the truck for *culpa contractual*. *Issue:* May the suit still prosper?

HELD: Yes, because the action is based on a contract. It is sufficient for him to prove the existence of the contract of carriage and the injuries suffered. It is not necessary for him to prove the negligence of the driver for this is presumed here. (Of course, if the driver can prove he was not negligent, the company would not be liable.)

- 6) Instances of recklessness on the part of the driver:
 - a) driving at an unjustified rate of speed;
 - b) flagrant violations of the elementary courtesies of the road;
 - c) failure to signal properly;
 - d) deliberate entry on one-way streets;
 - e) his *intoxication* at the time of the mishap [as distinguished from the mere drinking of hard liquor] (*Wright v. Manila Electric Co.*, 28 Phil. 122);
 - f) in general, an attempt to pass another vehicle which fails to give way (*Clayton v. McIllnath*, 241 Iowa 1162).
- 7) Instances of recklessness on the part of the owner, or operator himself:
 - a) failure to repair defective parts in the vehicle (*Lasam v. Smith*, 45 Phil. 657 and *Jose Son v. Cebu Autobus Co.*, L-6155, April 30, 1954) or allowing a worn-out condition of the vehicle (*Davao Gulf Lumber Corp. v. N. Baens del Rosario*, L-15978, Dec. 29, 1960) or the failure of the carrier to provide any cover at the right side of the bus to safeguard passengers sitting thereat

from falling therefrom. Failure of the passenger to hold on to the arm of the seat instead of the hand of a friend mitigates however the liability. (*Laguna Tayabas Bus Co. v. Cornista*, L-22193, May 29, 1964).

- b) failure to furnish a competent and tested driver, to whom the owner or operator must issue, when essential, proper instructions for safe maneuvering on the highway. (*Carf v. Medel*, 33 Phil. 37).
- (c) failure to detect a defect in an appliance purchased from a manufacturer, a defect that could have been discovered by the carrier. (*Necessito v. Paras, et al.*, GR L-10605 and L-10606, Jun. 30, 1958). (Here, the Court said that a passenger does *not* have the opportunity for inspection, which ordinarily, is available to the carrier.)

**Lourdes Munsayac v.
Benedicta de Lara
L-21151, Jun. 26, 1968**

FACTS: A driver of a jeepney was found recklessly negligent, thereby causing injuries to his passenger. Is the owner-operator of the jeepney liable for exemplary damages (in addition to other kinds of damages)?

HELD: Not necessarily. A principal or master can be held liable for exemplary or punitive damages based upon the wrongful act of his agent or servant only when he participated in the doing of such wrongful act or has previously authorized or subsequently ratified it, with full knowledge of the facts. Exemplary damages punish the intent — and this cannot be presumed on the part of the employer merely because of the wanton, oppressive, or malicious intent on the part of the agent.

Ambaan, et al. v. Bellosillo, et al.
CA-GR 56874-R, Jul. 8, 1981

The injured passengers of a public utility jeep driven by a reckless driver can sue the owner-operators of the jeep without the necessity of first bringing a criminal case against said driver. The governing law in such a case is the Civil Code which requires common carriers to carry their passengers safely to their destinations, with the exercise of extraordinary diligence. Considering the negligence of the driver, it is clear that under the master and servant rule, the liability of the owners-operators is not subsidiary, but direct and immediate. Indeed, the negligence of the servant in contractual obligations is the negligence of the master. The master and servant rule is also known as the doctrine of “*respondeat superior*.” Under this rule, the master, to escape liability, cannot put up the defense of a good father in the selection and supervision of employees (except to mitigate said liability, if this defense is duly proved).

(b) **CULPA AQUILIANA**

A *pedestrian* was hit by a taxi and suffered physical injuries. The taxi driver was *negligent* and was responsible for the injury.

- 1) This is *culpa aquiliana*, there being no previous existing contractual relations between the pedestrian on the one hand, and the taxi driver and the owner of the taxicab company, upon the other hand. (See *Hernandez v. Meralco*, 40 O.G. 10 S. No. 11, p. 35; *Lilius v. Manila Railroad Co.*, 59 Phil. 758 and *Gutierrez v. Gutierrez*, 56 Phil. 177).
- 2) The injured pedestrian can bring an action based on *culpa aquiliana* (tort or *quasi-delict*) against BOTH the *taxi driver* and the *owner or operator* of the taxicab company. *Reason*: The driver is responsible for his *negligence in making possible the injury*.

- 3) THEREFORE, in this case of *culpa aquiliana*, if the owner can prove due diligence in the *selection* and *supervision* of his *driver*, he could not have been responsible in any way for the injury. Thus, this *defense* is proper for the employer, and if proved, will exempt him from liability. (Here, the master-servant rule does not apply). (*Bahia v. Litonjua & Leynes*, 30 *Phil.* 424 and *Hernandez v. Meralco*, 40 *O.G.* [10 *S*] No. 14, p. 35).
- 4) Since it is the pedestrian who alleges negligence on the part of the defendant, it is his (the pedestrian's) duty to present and prove said negligence. In other words, he will have the burden of proof. As stated by the Supreme Court: "As a general rule, it is logical that in case of *culpa aquiliana*, a suing creditor should assume the burden of *proving* the existence of the negligence, as the only fact upon which his action is based." (*Cangco v. Manila Railroad Co.*, 38 *Phil.* 769, citing *Manresa*).

**Ibañez, et al. v. North Negros
Sugar Co., Inc., et al.
L-6790, Mar. 28, 1955**

Passengers of a private automobile who brought a criminal action against the driver of a train, and who reserved a civil action against the train owner, can still bring on the basis of *culpa aquiliana* the civil case against the train owner, even if the driver be *acquitted* in the criminal case.

(NOTE: Even without reservation, the civil case can also prosper. This is because the train owner is *not really* a defendant in the criminal case. Moreover, see Art. 2177, Civil Code.)

**Ramos v. Pepsi-Cola
L-22533, Feb. 9, 1967**

FACTS: A driver of Pepsi-Cola is admittedly negligent in a vehicular collision. Suit was brought

by the other car owner against both the driver and Pepsi-Cola. But Pepsi-Cola was able to prove diligence in selection (*no culpa in eligiendo*) and supervision (*no culpa in vigilando*) of the driver. *Issue*: Is Pepsi-Cola still liable?

HELD: No, otherwise it would have been liable solidarily with the driver. In Philippine torts, we do *not* follow the doctrine of *respondeat superior* (where the negligence of the servant is the negligence of the master). Instead, we follow the rule of *bonus familias* (good father of a family). The negligence of the employer here is *only presumptive*; it can therefore be rebutted, as in this case.

Vinluan v. Court of Appeals
L-21477-81, Apr. 29, 1966

FACTS: A passenger of a bus was hurt because of the negligence of the driver of the bus as well as the negligence of the driver of another vehicle. *Issue*: Who should be liable?

HELD: According to the court, four persons are liable: the owner of the bus, the driver of the bus, the owner of the other vehicle, and the driver of said other vehicle — and their liability is **SOLIDARY** — notwithstanding the fact that the liability of the bus company is predicated on a **CONTRACT**, while the liability of the owner and driver of the other vehicle is based on a **QUASI-DELICT**. (Observation: The bus driver can be excused on the basis of *culpa contractual* for the contract of common carriage was not with him, but with the bus company; nonetheless, he can be held liable on the basis of *culpa aquiliana*, there being no pre-existing contract between him and the passenger. Note also that the owner of the other vehicle can be excused if he can prove due diligence in the selection and supervision of his driver, under Art. 2180, last paragraph, unless at the time of the collision, said owner was also in his vehicle, in which case, notwithstanding due care in selection and su-

pervision, he would still be liable, if he could have, by use of diligence prevented the misfortune. (*See Art. 2184, Civil Code*).

**People v. Alejandro O. Tan, Jr.
CA-GR 21947-CR, Jul. 21, 1981**

If a driver on one side of the street desires to cross the same to be on the other side, it is not sufficient for him to put on the left signal light of the vehicle. It is of judicial notice that many drivers in our country today pay little heed to such a signal, particularly if the vehicle being driven by an approaching driver is speeding. What the driver intent on crossing should do is to simply WAIT for the other vehicle to pass, for after all, the other driver has the right of way. Failure to so wait is sheer negligence.

(c) *CULPA CRIMINAL*

A *pedestrian* was injured because of the *recklessness* of a taxi-driver. As we have already seen, the pedestrian can bring an action of *culpa aquiliana* against the *driver* and the *owner* of the taxi company. But if the pedestrian *wants*, he may bring an action for *culpa criminal* (physical injuries thru reckless imprudence). In the same way, *passenger* may bring not only a suit for *culpa contractual* but also a suit for *culpa criminal* (physical injuries thru reckless imprudence).

Procedure to be followed:

The *injured pedestrian* will file a criminal case *against* the *driver* (not against the owner). If the driver is found guilty, the owner will be *subsidiarily liable* if the driver is *insolvent*. The owner will *not* be allowed to present the defense of due diligence in the selection and supervision of his employee, for his liability is automatic and subsidiary. There is *no* necessity of previously reserving the case *against* the owner (because the owner is not a defendant in the criminal case). After the criminal case is terminated, the convicted driver should pay. If the driver be *insol-*

vent, the victim can now file a civil *action against* the owner to recover on the *latter's subsidiary liability*. All the victim has to do is:

- a) To present the judgment in the criminal case, declaring the driver *guilty*.
- b) To present *proof of driver's insolvency* by showing that the execution attempted by the sheriff could *not be satisfied*. In the absence of collusion between the driver and prosecuting attorney, once the 2 exhibits are presented or proved, the judge should order the *owner to pay*. The owner will not be allowed to present any defense anymore. He cannot, however, be said to have been deprived of his day in court because he also had his chance, *namely*, in the criminal case against the driver. *In said case, he should have given his driver a good defense counsel, because in defending the interest of the driver, the owner would also be defending his own interest, for his liability is automatic and dependent on the driver's guilt and insolvency. This is the rule in culpa criminal. (See Maria Luisa Martinez v. Manuel H. Barredo, et al., GR 49308 and Barredo v. Garcia, 73 Phil. 607).*

(NOTE: If a *passenger* sues for *culpa criminal*, substantially the same procedure as the above would be followed.)

(7) Some Cases

Barredo v. Garcia and Almario 73 Phil. 607

FACTS: A taxi-driver of Barredo killed Garcia thru reckless driving when the driver hit the *carretela* where Garcia was a passenger. The driver was found guilty in the criminal case (*culpa criminal*). But the civil action had been reserved. Later, the heirs of Garcia brought a civil action (*culpa aquiliana*) directly against Barredo, the owner of the taxicab company

(Malate Taxicab Company). It was proved that Barredo was negligent for his driver had been employed by him even if he had previously been convicted for violation of the Automobile Law. Barredo contended, however, that the action should *not* have been brought against him at once, because according to the Revised Penal Code, he should be liable only if the driver cannot pay, and that therefore, the civil action should have been brought first against the driver, and then, if the driver is found guilty and insolvent, this would not be the proper time to take the action against him (Barredo). Decide.

HELD: Barredo is confused. It is true that in a civil obligation arising from a crime, the employer would be only *subsidiarily* liable in case the employee committed the crime in the discharge of his duties. BUT this case is not one of the civil liability arising from a crime, but one arising from a *quasi-delict* or *culpa aquiliana*. And under the Civil Code provisions on torts, an employer in a case like this is not merely subsidiarily, but *primarily* liable, and therefore a case can be brought directly against him. His defense can be due diligence in the selection and supervision of his employees, but here, he *was proved* to be negligent. Hence, he can be made to pay immediately.

Nagrania v. Muluaney, Inc.
L-8326, Oct. 24, 1955

FACTS: The driver of an employer was *criminally* found *guilty* of damage to property, and because he was *insolvent*, the employer was sued for his subsidiary civil liability. The victim asked for P1,300, but the employer, in his answer, admitted liability for only P300 (or P1,000 *less*). **Issue:** If both parties asked for judgment on the pleadings, can the employer be held liable for the whole P1,300 which had been adjudged as the driver's liability?

HELD: Yes, because of his *automatic subsidiary* liability once the driver is found *criminally guilty and insolvent*. The offer of P300 was an implied admission of both the driver's conviction and insolvency. That he admitted a *less* amount is *immaterial* for, under the law, his is a *complete* subsidiary liability.

**Maria Luisa Martinez v. Manuel B. Barredo,
et al., GR 49308**

FACTS: On Apr. 11, 1940 a taxicab owned by Fausto Barredo and driven by Rosendo Digman collided with a Chevrolet car driven by Maria Luisa Martinez. A criminal case was instituted against the taxi driver, who pleaded guilty, and was made to pay a fine and to *indemnify* Martinez. Due to Digman's *insolvency*, Martinez filed an action against Barredo to hold him *subsidiarily liable*. At the trial, Martinez relied solely on:

- a) the judgment of conviction against Digman;
- b) the writ of execution issued against Digman and proof of his insolvency.

ISSUE: Would the evidence of Martinez be sufficient to hold Barredo civilly liable?

HELD: Yes, the judgment of conviction plus proof of insolvency is *sufficient* to hold the employer subsidiarily liable; in the absence of collusion between the driver and the victim, the stigma of a criminal conviction surpasses in effect mere civil liability. Common sense dictates that a finding of guilt in a criminal case in which proof beyond reasonable doubt is necessary, should not be nullified in a subsequent civil action requiring only preponderance of evidence. Barredo cannot be said to have been deprived of his day in court because the liability really depended upon the driver's *guilt* and *insolvency*, the liability being automatic and subsidiary. It is high time that employers should have their employees defended very well, supplying them with counsel, for in defending his employees' interest (in a criminal case), he, the employer, is automatically defending himself. It would have been different had the case been one of *culpa aquiliana*.

[NOTE: This ruling was reiterated in the case of *Manalo, et al. v. Robles Trans. Co., Inc.*, L-8171, Aug. 16, 1956. In said case the Court also held that the sheriff's return of the writ of execution showing non-satisfaction of the judgment because of accused's insolvency was *admissible* in evidence and the sheriff does not need to testify in court as to the fact stated in the entry because it is an official judgment. Moreover, the civil case can

be brought *not within only four years* but within ten (10) years because it arises out of a final judgment.]

People of the Philippines v. Jesus Verano
L-15805, Feb. 28, 1961

FACTS: Dominador Paras, a passenger in a truck of the Mindanao Bus Co., was killed when the truck driven by Jesus Verano figured in a vehicular accident. The Bus Co. paid the heirs of the deceased P3,000. Mrs. Paras, in her own behalf, and on behalf of her minor children with the deceased, *waived* further rights to recover damages. Verano was subsequently charged with homicide thru reckless imprudence. After trial, the lower court found him guilty. In addition to the sentence of imprisonment, Verano was ordered to pay the heirs of the deceased, Paras, the sum of P5,000 with subsidiary imprisonment in case of insolvency. The issues are whether the waiver in favor of the company embraces the civil liability of the driver; whether the right to recover upon the civil liability arising from the crime may be waived and whether such waiver may be made in behalf of the minor heirs by their mother.

HELD:

- a) The waiver in favor of the company includes the civil liability of the driver, for in case of insolvency on the part of the driver, the company is *liable* under the Revised Penal Code. For the heirs to also recover from the driver would be to grant them *double* indemnity.
- b) Under the Rules of Court, civil liability, whether arising from a crime or not, can be waived.
- c) The waiver by Mrs. Paras in her own behalf is valid, but not that in behalf of her minor children, since although she is the administrator of their property, the waiver or compromise should have had court approval, being an act of ownership and not mere administration. (*Arts. 320, 2032, Civil Code and Visayan v. Suguitan, L-8300, Nov. 18, 1955*). Therefore, since P3,000 had already been paid, the heirs may still recover P2,000, the part that had NOT been validly waived. In other words, the indemnity in the criminal case was reduced to P2,000.

- d) *Art. 2177 says: "Responsibility for fault or negligence under Art. 2176 — culpa aquiliana — is entirely separate and distinct from the civil liability arising from negligence under the Penal Code (ex delicto). But the plaintiff cannot recover twice for the same act or omission of the defendant."*

Virata v. Ochoa
L-46179, Jan. 31, 1978

A driver's acquittal in a criminal case is not a bar to a civil case for damages. What is prohibited is a *double* recovery for the same negligent act.

(8) Effects of Victim's Own Negligence and of His Contributory Negligence

- (a) When a plaintiff's own negligence was the *immediate* and *proximate* cause of his injury, he cannot recover damages (because there is no *culpa aquiliana* on the part of the defendant). (*Art. 2179, Civil Code*). *Example*: A pedestrian, not looking where he was going, bumped into a carefully driven car. He *cannot* recover damages in *culpa aquiliana*. As a matter of fact, if any damage was caused the car, the owner can recover from the pedestrian.

Ong v. Metropolitan Water District
L-7664, Aug. 29, 1968

FACTS: A visitor was drowned in a swimming resort due to his own negligence, and despite measures on the part of the resort authorities to save him. *Issue*: Is the resort liable?

HELD: No, the resort is NOT liable. While it is duty-bound to provide for safety measures, still it is not an absolute insurer of the safety of its customers or visitors. The doctrine of "last clear chance" cannot apply if the:

- 1) negligence of the plaintiff is concurrent with the negligence of the defendant;
- 2) party charged is required to act instantaneously;

- 3) injury cannot be avoided despite the application at all times of all the means to avoid the injury (after the peril is, or should have been, discovered), at least in all instances where the previous negligence of the party charged cannot be said to have contributed to the injury at all.
- (b) If the plaintiff's negligence was only *CONTRIBUTORY*, the immediate and proximate cause of the injury being the defendant's lack of due care, the plaintiff may recover damages, BUT the courts shall mitigate the damages to be awarded. (*Art. 2179, Civil Code*).

Rakes v. Atlantic Gulf and Pacific Co.

7 Phil. 359

FACTS: Rakes, a Negro, was at work transporting iron rails from a barge in the harbor to the yard of the Atlantic Gulf and Pacific Company. At a certain spot, the railroad track broke, upset the cart, and hit Rakes. His leg was afterwards amputated. It was proved that the cause of the accident was a defect in the track, a depression therein. Previously the depression had been noticed, but the repair upon it was done *negligently*. There is no question therefore of the Company's negligence. But the Company countered by saying that Rakes himself was negligent in two respects:

- 1) Although he noticed the depression, he still continued with his work;
- 2) Instead of walking in front or behind the car, Rakes walked at the side.

The Court dismissed the first ground by saying that Rakes did *not* know that the track has been repaired negligently. The second ground, however, was admitted to show Rakes' negligence.

Issue: Is this negligence of Rakes sufficient to bar him from a recovery of damages?

HELD: No, this negligence of Rakes did not bar him from recovering damages. Rakes did not contribute to the

accident; he only contributed to the *injury* or *damage* upon himself. Therefore, he can still recover, but the damages should be reduced or mitigated because of his own contributory negligence.

(9) Some Doctrines

- (a) If an employer company fails to warn an ignorant employee to be careful about an unfamiliar machine, it should respond for damages in case of injury. (*Tamayo v. Gsell*, 35 Phil. 953).
- (b) The mere fact that a man was drunk at the time of an accident does not mean he was negligent, provided he exercised due care. (*Wright v. Manila Electric Co.*, 28 Phil. 122).
- (c) Storing potatoes in a very tight and unventilated *lorcher* under a burning sun causing them to rot is gross negligence. (*Hashim and Co. v. Rocha and Co.*, 18 Phil. 315).
- (d) Abandoning a towed vessel in a calm sea just because the tow line broke, and with full knowledge that it might get lost, is negligence. (*Guzman v. X & Behn and Meyer, & Co. v. Phil. Motors Corp.*, 55 Phil. 129).
- (e) If a streetcar passenger is hurt *because* of an accident where there was no *negligence* at all, the streetcar company *cannot* be liable for *culpa contractual* for there was no negligence. (*Carlos Goco v. Meralco*, 37 O.G. p. 2275). A tire blow-out does not constitute negligence unless the tire was already old and should not have been used at all. Indeed, this would be a clear case of a fortuitous event. (*Rodriguez v. Red Line Transportation Co.*, [C.A.] 51 O.G. 3006, June. 1955).
- (f) Negligence is a question depending upon the facts of each particular case; indeed it is a question of fact. (*Tucker v. Milan*, [C.A.] 49 O.G. 4379).

(10) Liability for the Culpa Aquiliana of Others

- (a) The father and, in case of his death or incapacity, the mother, are responsible for the damages caused by the *minor* children who live in their company, unless the parent can prove that he or she observed all the diligence of

a good father of a family to prevent damage. (*Art. 2180, Civil Code*).

- (b) Guardians are liable for damages caused by the *minors or incapacitated* persons who are under *their authority* and live in their company, unless said guardians observed all the diligence of a good father of a family to prevent damage. (*Art. 2180, Civil Code*).
- (c) Employers shall be liable for the damages caused by their employees and household helpers acting within the scope of their assigned task, *even though* the former are *not engaged* in any business or industry, unless said employers can prove that they observed all the diligence of a good father of a family to prevent damage. (*Art. 2180, Civil Code*).
- (d) Whoever *pays* for the damage caused by his dependents or employees *may recover* from the latter what he had paid or delivered in satisfaction of the claim. (*Art. 2181, Civil Code*).
- (e) Provinces, cities, and municipalities shall be liable for damages for the *death* of or *injuries* suffered by any person by reason of the *defective* buildings, and other public works under their control or supervision. (*Art. 2189, Civil Code*).

Goldin v. Lipkind
(Fla) 49 So. 2nd, 539
27 ALR 2d 816 (1953)

An innkeeper is under a duty to exercise ordinary care to keep hallways reasonably well-lighted and free from obstructions and will, therefore, be liable in case a guest is injured when the hallway to his room is *not lighted*, and he trips over a *mattress* carelessly placed in the dark hall.

Art. 1173. The fault or negligence of the obligor consists in the omission of that diligence which is required by the nature of the obligation and corresponds with the circumstances of the person, of the time and of the place. When negligence shows bad faith, the provisions of Articles 1171 and 2201, paragraph 2, shall apply.

If the law or contract does not state the diligence which is to be observed in the performance, that which is expected of a good father of a family shall be required.

COMMENT:

(1) Degrees of Culpa Under Roman Law

Art. 1173 *changes* the degrees of *culpa* known under Roman Law, which were as follows:

- (a) *culpa lata* — grave negligence
- (b) *culpa levis* — ordinary negligence
- (c) *culpa levissima* — slight negligence

[NOTE: Under Roman Law —

- 1) If *slight diligence* is required, it is only *grave negligence* that will make the debtor liable.
- 2) If *ordinary diligence* is required, it is *ordinary negligence* that will make the debtor liable.
- 3) If *great diligence* is required, even *slight negligence* will make the debtor liable.]

(NOTE: The classification above has not been followed in the Civil Code because today there are very many kinds or degrees of diligence required.)

(2) Kinds of Diligence Under the Civil Code

Under the Code, the following kinds of diligence are required:

- (a) that agreed upon by the parties
- (b) in the absence of (a), that required by the law (particular provision)

[NOTE: The responsibility of a common carrier is EXTRAORDINARY and lasts from the time the goods are placed in its possession until they are delivered actually or constructively, to the consignee or to the person who has a right to receive them. (Art. 1736, Civil Code). It can

only be exempt therefrom for causes enumerated in Art. 1734. (*American Pres. Lines v. Richard A. Klepper, et al.*, L-15671, Nov. 29, 1960).]

- (c) in the absence of (b), that expected of a good father of a family (*bonum pater familia*)

[NOTE: In a contract with a *common carrier* for *passengers* (like a taxi or a jitney) the law provides that the carrier is bound to carry the passengers safely as far as human care and foresight can provide, using the utmost diligence of *very cautious* persons, with a due regard for all the circumstances. (Art. 1755, Civil Code). This is so even if the passenger is carried free or at a reduced rate. (Art. 1758, *id.*). Upon the other hand, the passenger should observe the diligence of a good father of a family to avoid injury to himself. (Art. 1761, *id.*). But the contributory negligence of the passenger *does not bar recovery* of damages for his death or injuries, if the proximate cause thereof is the negligence of the common carrier, but the amount of damages shall be *equitably reduced*. (Art. 1762, *id.*).]

[NOTE: The Public Service Commission *may*, on its own motion or on petition of any interested party, after due hearing, cancel the certificate of public convenience granted to any common carrier that *repeatedly fails* to comply with his or its duty to observe extraordinary diligence. (Art. 1765, *id.*).]

Glenn v. Haynes
192 Va. 574 (1953)

If an *attorney* loses thru theft by a criminal the property of his client which had been delivered to him, the attorney is presumed to have been negligent in taking care of said property and would ordinarily be liable.

Drybrough v. Veech
238 SW 2d, 996 (1953)

ISSUE: If an automobile with a fur coat inside is left inside a parking lot, but the attention of the parking lot attendant is *not called* to the presence of the *fur coat*, should the owner

of the parking lot be liable in case the fur coat is stolen by an outsider?

HELD: No, for while there was a deposit (bailment) of the car, there was *no deposit* of the *fur coat*.

**Davao Gulf Lumber Corp. v.
N. Baens del Rosario, et al.
L-15978, Dec. 29, 1960**

If a truck driver, in violation of company regulations, allows his wife and children to ride with him on the truck, this is NOT by itself negligence. On the contrary, their presence would make the driver *extremely careful*.

**Far East Bank and Trust Co. v. Estrella O. Querimit
GR 148582, Jan. 16, 2002**

FACTS: Respondents filed a complaint against petitioner-bank and certain officials of the latter, alleging that that they refused to allow her to withdraw her time deposit evidenced by four certificates of deposit in the total amount of \$60,000. The trial court ordered petitioner-bank and its officials to allow respondent to withdraw her time deposit plus accrued interests. The Court of Appeals (CA) affirmed the decision of the trial court with the modification that petitioner-bank was solely liable because the latter had a personality separate from its officers and stockholders. On appeal, the Supreme Court affirmed the CA.

HELD: Petitioner-bank failed to prove that it had already made payment considering that the subject certificates of deposit were still in the possession of the depositors. The principle that payment, in order to discharge a debt, must be made to someone authorized to receive it is applicable to the payment of certificates of deposit. Petitioner should, thus, not have paid respondent's husband or any third party the amount of the time deposit without requiring the surrender of the certificates of deposit. Laches would also not defeat respondent's claim as she did not withdraw her deposit because she relied on petitioner bank's assurance that interest would accumulate annually even-

after maturity of the time deposit and she set aside the money therein for her retirement.

Art. 1174. Except in cases expressly specified by the law, or when it is otherwise declared by stipulation or when the nature of the obligation requires the assumption of risk, no person shall be responsible for those events which could not be foreseen, or which though foreseen, were inevitable.

COMMENT:

(1) General Rule for Fortuitous Events

No liability for a *fortuitous event* (*caso fortuito*) (that which could not be foreseen, or which even if foreseen, was inevitable).

(2) Exceptions — The debtor is responsible for a fortuitous event in the following cases:

(a) *When expressly declared by the law* [such as when the possessor is in BAD faith (*Art. 552, Civil Code*) or is in *default*. (*Art. 1165, Civil Code*).]

(b) *When expressly declared by stipulation or contract* [such as when the contract says:

“If there be a fortuitous event that would cause delay in the delivery of padlocks, *an extension must be sought*, otherwise, damages can be asked.” (*See Republic of the Philippines v. Litton & Co., GR L-5018, Nov. 28, 1953*).]

(c) *When the nature of the obligation requires the assumption of risk* (the doctrine of CREATED RISK) [*Example*: When a carrier transports dynamite, and because of an accidental tire blow-out it injures nearby property, the carrier would be responsible. This is because of the nature of carrying dynamite. Upon the other hand, injuries caused by a tire *blow-out* of a perfectly new tire, or at least a still good one, when *no explosives* or *dangerous* things were being carried, are due to an unavoidable accident, and the owner of the car would not be liable. (*See Rodriguez v. Red Line Transportation Co., [C.A.] 51 O.G. 3006, Jun. 1955*).]

(3) Equivalent Terms for Fortuitous Event

- (a) *caso fortuito* (literal translation)
- (b) act of God (like lightning)

**Juan F. Nakpil and Sons, et al. v. CA, et al.
GR 47851, Oct. 3, 1986**

To exempt the obligor from liability for a breach of an obligation due to an “act of God,” the following must concur: (a) the cause of the breach of the obligation must be independent of the will of the debtor; (b) the event must be either unforeseeable or unavoidable; (c) the event must be such as to render it impossible for the debtor to fulfill his obligation in a normal manner; and (d) the debtor must be free from any participation in, or aggravation of, the injury to the creditor.

An act of God is an accident, due directly and exclusively to natural causes without human intervention, which by no amount of foresight, pains or care, reasonably to have been expected, could have been prevented.

- (c) *force majeure* (like war or armed robbery) but if the war had already broken out *before* the contract was entered into, the war cannot be considered unforeseen. (*Server v. Eisemberg and Co., L-10741, Mar. 29, 1951*).
- (d) unavoidable accident (like a tire blow-out provided there was no negligence)

(4) Essential Characteristics of a Fortuitous Event

- (a) the cause must be independent of the will of the debtor (freedom from PARTICIPATION or AGGRAVATION);

Example: Loss of a firearm which fell to the bottom of the sea when the ship sank during a storm. (*Insular Gov't. v. Bingham, 13 Phil. 558*).

- (b) impossibility of foreseeing or impossibility of avoiding it, even if foreseen;

Example: Damage to train passengers when the train is hit by *lightning*.

- (c) the occurrence must be such as to render it impossible for the debtor to fulfill his obligation in a normal manner.

Examples: Armed robbery causing the loss of a specific radio, but not if money is taken for money is a generic thing; seizure by the Japanese military forces, during the war, of copra deposited in a warehouse. (*North Negros Sugar Co. v. Co. Gen. de Tabacos*, L-9277, Mar. 29, 1957).

(5) Some Cases

Lasam v. Smith **45 Phil. 657**

FACTS: A passenger was hurt when the car he was riding on figured in an “accident” caused either by the driver’s *recklessness or car defects*.

HELD: The operator is liable since this is not a case of fortuitous event. (This ruling was reiterated in the case of *Jose Son v. Cebu Autobus Co.*, L-6155, Apr. 30, 1954, where the defect was in the drag-link spring.)

Republic of the Philippines v. Litton and Co. **94 Phil. 52**

FACTS: The defendant promised to deliver to the plaintiff (government) on or before Mar. 1, 1946, 96,000 padlocks for election purposes but was not able to deliver two-thirds because of certain unforeseen events (such as the vessel being stranded at a certain island or transportation detour). In the contract, the following provision was made: “Should there be delay in delivery, due to a condition clearly beyond the contractor’s control, the Purchasing Agent may grant a *reasonable time* for extension if *applied for before default is incurred*. Deliveries made within the extended period shall not be subject to penalties.” Although there apparently were unavoidable causes preventing delivery on time, contractor failed to properly ask for the needed extension. *Issue:* Is he liable?

HELD: Yes, the contractor is liable, because properly interpreted, the provision quoted above is one that clearly imposes

liability even for fortuitous events. Such a stipulation is clearly allowed by the law.

**Victorias Planters Assn., et al. v.
Victorias Milling Co., Inc.
97 Phil. 318**

FACTS: In a contract, it was agreed that for 30 years, the planters would deliver their sugar to a milling company. However, during the war (4 years) and during the period of reconstitution (2 years), the milling company could not operate its mill. *Issue:* Should the period of 6 years be made up? In other words, should the planters be required to deliver for 6 more years their sugar to the same mill to make up for what had been lost?

HELD: No more, because war is a fortuitous event that would relieve the planters from this obligation since fulfillment then had been rendered impossible.

**Crane Sy Pauco v. Gonzaga
10 Phil. 646**

FACTS: Pending the decision of a case against him, the carabaos of *L* were attached by a sheriff. *L* gave a *bond* for their release, the condition being that if *L* loses the case, *L* would deliver the animals. *L* lost, but was not able to deliver the carabaos, because they had died due to cause not imputable to *L*. *Issue:* Are the bondsmen liable?

HELD: No, the bondsmen are not liable because the death of the carabaos was fortuitous. Thus, the obligation to deliver the carabaos was extinguished.

Question: But is it not true that the bondsmen (who had executed the bond) were precisely supposed to answer in case of non-delivery?

ANS.: Yes, they were precisely supposed to answer but only if *L* were to *deliberately withhold* delivery. Here, *L*, was excused from returning (*the principal obligation*); hence, the guaranty (*the second obligation*) is automatically extinguished, since the contract *did not* provide for liability even in case of *force majeure*.

Bailey v. Le Crespigny
Law Reports, 40 B 180

FACTS: A enters into a contract with B obligating himself under a bond to construct a dwelling house upon a particular tract of land. But before completion of the construction, the government expropriated the land; hence, fulfillment was not made. *Issue:* Is A liable?

HELD: No, for this was unforeseen. To decide contractwise would be nauseating to the very idea of justice.

Sian, et al. v. Lopez, et al.
L-5398, Oct. 20, 1954

If a fire fortuitously breaks out and surrounding houses are destroyed because of their nearness, lack of water, and an unfortunate high breeze, no one can be held responsible.

Pacific Vegetable Oil Corporation v. Singson
L-7917, Apr. 29, 1955

FACTS: A was obliged to perform a certain obligation in B's favor. But a fortuitous event happened. Later, A and B agreed that because of what had happened, A would be given a new period. But when the period arrived, A was still not able to perform. *Issue:* Can A *plead* fortuitous event as a defense?

HELD: No more, because the settlement was made AFTER, and *not before*, the fortuitous event, implying a *waiver of any defense* on this ground which he could have raised before.

Tan Chiong Sian v. Inchausti & Co.
22 Phil. 152

If a ship owner, knowing the dangerous and weak condition of his vessel, nevertheless orders his captain to embark on a voyage, and during said voyage a *typhoon* causes the destruction of both the ship and its cargo, the owner will still be held liable. He cannot absolve himself by crying "an act of God."

Soriano v. De Leon, et al.
(C.A.) 48 O.G. 2245, Jun. 1952

If a debtor fails to perform because of floods and inadequate transportation, he is not responsible.

U.S. v. Mambag
36 Phil. 384

If a *stolen* carabao dies because of a fortuitous event, the thief is still liable unless the creditor-owner is in *mora accipiendi*.

Nakpil and Sons v. CA
GR 47851, Oct. 3, 1986

FACTS: The building contractor and the architect made substantial deviations from the plans and specifications and failed to observe the requisite workmanship in the construction as well as to exercise the requisite degree of supervision; while the plans and specifications prepared by the architects contained inadequacies and defects. The defects in the construction and in the plans and specifications were the proximate causes that rendered the building unable to withstand the earthquake.

HELD: The contractor and the architect cannot claim exemption from liability. The wanton negligence of both the building contractor and the architect in effecting the plans, designs, specifications, and construction of the building is such negligence as to amount to bad faith in the performance of their respective tasks. One who negligently creates a dangerous condition cannot escape liability for the natural and probable consequences thereof, although the act of a third person, or an act of God for which he is not responsible, intervenes to precipitate the loss.

Gatchalian v. Delim
GR 56487, Oct. 21, 1991

To exempt a common carrier from liability for death or physical injuries to passengers upon the ground of *force majeure*, the carrier must clearly show not only that the efficient cause of the casualty was entirely independent of the human will, but

also that it was impossible to avoid. Any participation by the common carrier in the occurrence of the injury will defeat the defense of *force majeure*. Where fortuitous event or *force majeure* is the immediate and proximate cause of the loss, the obligor is exempt from liability for non-performance. The *partidas*, the antecedent of Article 1174 of the Civil Code, defines “*caso fortuito*” as an event that takes place by accident and could not have been foreseen. Examples of this are destruction of houses, unexpected fire, shipwreck, violence of robbers.

In a legal sense and consequently, also in relation to contracts, a *caso fortuito* presents the following essential characteristics: (1) the cause of the unforeseen and unexpected occurrence or the failure of the debtor to comply with his obligation, must be independent of the human will; (2) it must be impossible to foresee the event which constitutes the *caso fortuito*, or if it can be foreseen, it must be impossible to avoid; (3) the occurrence must be such as to render it impossible for the debtor to fulfill his obligation in a normal manner; and (4) the obligor must be free from any participation in the aggravation of the injury resulting to the creditor.

**Roberto C. Sicam, et al. v. Lulu V. Jorge, et al.
GR 159617, Aug. 8, 2007**

FACTS: Under Sec. 17 of Central Bank Circular 374, Rules and Regulations for Pawnshops, which took effect on Jul. 13, 1973, and which was issued pursuant to PD No. 114, the Pawnmakers Regulation Act, it is provided that pawns pledged must be insured. However, this Section was subsequently amended by CB Circular 764, which took effect on Oct. 1, 1980. According to Sec. 13 thereof, office building/premises and pawns of a pawnshop must be insured against him — and where the requirement that insurance against burglary was deleted. Obviously, the Central Bank (now Bangko Sentral) considered it not feasible to require issuance of pawned articles against burglary. In the case at bar, a robbery in a pawnshop happened in 1987. **Issue:** Considering the abovesited amendment, is there a statute duly-imposed on petitioner to insure the pawned jewelry in which case it was error for the Court of Appeals (CA) to consider it as a factor in concluding that petitioners were negligent.

HELD: There is none. Nevertheless, the preponderance of evidence shows that petitioners failed to exercise the diligence required of them under the New Civil Code. The diligence with which the law requires the individual at all times to govern his conduct varies with the nature of the situation in which he is placed and Receipts Law. (*Pilipinas Bank v. Ong*, 435 Phil. 732 [2002]). Further, the party invoking novation must prove that the new contract did indeed take effect. (*Diongzon v. CA*, 378 Phil. 1090 [1999]).

(6) Loss in a Shipwreck

As a general rule, the loss of the ship due to a fortuitous event should be borne by its owner; the loss of the cargo, by their owners, unless the captain lacked skill, or there was malice or negligence. (*Tan Chiong Sian v. Inchausti & Co.*, *supra*).

(7) Loss Because of an Act of Government

In *Sabelino v. RFC* (L-11790, Sept. 30, 1958), it was held that the RFC and the PNB could be forced to accept 30-year term backpay certificates in payment of mortgage obligations despite the fact that acceptance thereof would freeze a large part of their assets and compel them to sustain losses and reduction in yield. The acceptance must be allowed because it is so provided under *Rep. Act 897*. This law is an act of sovereign power and, therefore, whatever loss incurred can be attributed to a *force majeure*, and certainly the State cannot complain of a loss caused by itself.

(8) Combination of Fortuitous Event and Negligence

Suppose there is a combination of a fortuitous event and negligence on the part of the debtor, is the obligation to deliver a specific thing extinguished?

ANS.: It depends:

- (a) If the *fortuitous event* was the proximate cause, the obligation is extinguished.
- (b) If the *negligence* was the proximate cause, the obligation is *not* extinguished. (It is *converted* into a monetary obligation for damages.)

Art. 1175. Usurious transactions shall be governed by special laws.

COMMENT:

(1) ‘Usury’ Defined

It is contracting for or receiving *something in excess* of the amount allowed by law for the loan or use of money, goods, chattels, or credits. (*Tolentino & Manio v. Gonzales Sy Chiam, 50 Phil. 558*). In other words, usury is the exaction of excessive interest.

(2) Kinds of Interest

There are two kinds of interest:

- (a) Interest given for *compensation or use* of the money (also called by some authors as MORATORY INTEREST).

Example: I borrowed P1 million at 8% interest *per annum* for 3 years. (This is the kind of interest regulated by the *Usury Law*.)

- (b) Interest given by *way of damages* (also referred to by some authors as COMPENSATORY INTEREST, *i.e.*, it compensates the damage caused).

Example: I borrowed P1 million with no *interest* for 3 years. If I pay at the end of three years, I pay no interest. If I incur *default* (do not pay even after demand), I *will* now be responsible for interest (by way of damages) at the rate of 6% *per annum*, to be counted from default.

(3) Regard of People for Usury

Usury has been regarded with abhorrence from the earliest times. (*Tolentino & Manio v. Gonzales Sy Chiam, supra*). It was prohibited by the ancient laws of the Chinese and Hindus, the Koreans, the Athenians, and the Romans. (*U.S. v. Constantino, 39 Phil. 554*). HOWEVER, today the Usury Law has been REPEALED by Central Bank (now Bangko Sentral) Circular 905, effective Jan. 1, 1983.

(4) Definition of Simple Loan (Mutuum)

By the contract of simple loan, one of the parties delivers to another money or other consumable things upon the condition that the same amount of the same kind and quality shall be paid. (*Art. 1933, Civil Code*).

(5) Lawful and Legal Rates

Under the former Usury Law:

- (a) *Lawful rates (authorized rates)* — those allowed as *maximum* under the former Usury Law.
 - 1) *12% per annum* — if secured in *whole* or in part by a *mortgage upon real estate*, if the *title* to the real estate is *duly recorded*; or by any document *conveying such* real estate (also registered estate) or an interest therein. (*Sec. 2, Usury Law, as amended by Com. Act 399*).
 - 2) *14% per annum* — if not secured as provided above (*Sec. 3, Usury Law, as amended by Com. Act 399*).
 - 3) For pawnshops:
 - a) *2 1/2% a month* — if sum lent is less than P100.
 - b) *2% a month* — P100 to P500
 - c) *14% per annum* — if more than P500

[*NOTE*: It shall be *unlawful* for a pawnbroker or his agent to *divide* the pawn offered by a person into two or more fractions, in order to collect greater interest than that permitted. Furthermore, it shall also be unlawful to require the pawner to pay an additional charge as insurance premium for the safekeeping and conservation of the article pawned. (*Sec. 4, Usury Law, Act 2655 as amended by Com. Act 399*).]

[*NOTE*: The rates given above have already been changed (from time to time) by the Monetary Board and by the Bangko Sentral).]

- (b) *Legal Rate* (that presumed by the law to have been agreed upon if the loan mentions interest but no rate was stipulated)

This used to be 6% *per annum* (Art. 2209, *Civil Code*; see Sec. 1, Act 2655). It is now 12% *per annum* as directed by a Central Bank (Bangko Sentral) Circular.

[NOTE: No interest (by way of compensation for its use) will be given in case it is not expressly stipulated in writing. (Art. 1954, *Civil Code*).]

(6) Important Distinction Between Secured (Sec. 2) and Unsecured (Sec. 3) Loans — Under the Old Usury Law

- (a) Sec. 2 penalizes the *taking* or *receiving* of excessive interest (not the mere agreeing)
- (b) Sec. 3 penalizes *not only* the *taking* or *receiving*, but *also* the *demanding* or the *agreeing* to charge an excessive rate. (Of course, in both cases, it is only the CREDITOR who is guilty). (See *People v. Bernate*, 36 O.G. p. 2720).

(7) Inconsistency in the Code

In case of conflict, which should prevail, the Civil Code or the Usury Law?

ANS.: The Civil Code answered this *inconsistently*.

- (a) In Art. 1175, it is evident that the *Usury Law* prevails — “Usurious transactions shall be governed by special laws.”
- (b) Yet, in Art. 1961, the law says the *Civil Code* prevails — “Usurious contracts shall be governed by the Usury Law and other special laws *so far as they are not inconsistent* with this Code.”

(NOTE: Either of the two conflicting articles *must* be repealed.)

(NOTE: In the case of *Cherie Palileo v. Beatriz Cosio*, L-7667, Nov. 28, 1955, the Supreme Court applied the Civil Code instead of the Usury Law. However, the decision did *not* discuss the conflict.)

(NOTE: In the case, however, of *Angel Jose Warehousing Co., Inc. v. Chelda Enterprises and David Syjuico*, L-25704, Apr. 24, 1968, the Court held that with respect to the question — “how much interest can be recovered by a debtor who has paid *usurious* interest?” — the interest recoverable is the *entire interest agreed upon* for such entire interest is VOID. The Court further held that with respect to said question, there is NO CONFLICT between the Civil Code and the Usury Law.)

**Angel Jose Warehousing Co., Inc. v.
Chelda Enterprises and David Syjuico
L-25704, Apr. 24, 1968**

FACTS: A partnership (Chelda Enterprises and David Syjuico) borrowed P20,000 from Angel Jose Warehousing Co. at clearly usurious rates (from 2% to 2 1/2% PER MONTH).

ISSUES:

- (a) Can creditor recover the PRINCIPAL debt?
- (b) If the entire usurious rate has been paid by the debtor, how much of it can be recovered by said debtor from the creditor?

HELD:

- (a) Yes, the creditor can recover the PRINCIPAL debt. The contract of loan with usurious interest is *valid as to the loan*, and *void only with respect to the interest* — for the loan is the *principal* contract while the interest is merely an *accessory* element. The two are separable from each other. (See *Lopez v. El Hogar Filipino*, 47 Phil. 249). The ruling on this point by the Court of Appeals in the case of *Sebastian v. Bautista*, 58 O.G. No. 15, p. 3146, holding that even the loan itself is void is WRONG.
- (b) With respect to the usurious interest, the *entire interest agreed upon* is void, and if already paid, may be recovered by the debtor. It is *wrong* to say that the debtor can recover only the *excess* of 12% or 14%, as the case may be — for the simple reason that the *entire interest stipulation is indivisible*, and being illegal, should be considered entirely void. It is *true* that Art. 1413 of the Civil Code states that “interest

paid in *excess* of the interest allowed by the Usury Law may be recovered by the debtor with interest thereon from the date of payment.” But, as we construe it, Art. 1413, in speaking of “interest paid in excess of the interest allowed by the usury laws” means the *whole usurious interest*: that is, in a loan of P1,000, with interest of 20% *per annum* or P200 for one year, if the borrower pays said P200, the *whole* P200 is the *usurious interest* not just that part thereof in excess of the interest allowed by law. It is in this case that the law does *not* allow division. The whole stipulation as to interest is void since payment of said interest is the cause or object, and said interest is illegal. Note that there is *no conflict* on this point between the New Civil Code and the Usury Law which states in Sec. 6, that any person who for a loan shall have paid a higher rate or greater sum or value that is allowed in said law, may recover the *whole interest* paid. The only change effected, therefore, by Art. 1413 of the New Civil Code is *not* to provide for the recovery of interest paid in excess of that allowed by law, which the Usury Law already provided for, but to add that the same can be recovered “with interest thereon from the date of payment.” The foregoing interpretation is reached with the philosophy of usury legislation in mind: to discourage stipulations on usurious interest, said stipulations are treated as wholly void, so that the loan becomes one *without* stipulations as to payment of interest. It should not, however, be interpreted to mean forfeiture even of the principal, for this would unjustly enrich the borrower at the expense of the lender. Furthermore, penal sanctions are available against a usurious lender, as a further deterrent to usury.

The principal debt remaining *without stipulation* for payment of interest can thus be recovered by judicial action. And in case of such demand and the debtor incurs *in delay*, the debt earns interest from the date of the demand, whether judicial or extrajudicial (in the instant case, from the filing of the complaint). Such interest is *not* due to *stipulation*, for there was none, the same being void. Rather, it is due to the general provision of law that in obligation to pay money, where the debtor incurs in delay, he has to pay interest by way of damages. (*Art. 2209, Civil Code*).

**Liam Law v. Olympic Sawmill
L-30771, May 28, 1984**

1. The requirement in the Usury Law and the Rules of Court that an allegation of usury, if it is denied, must be denied *under oath*, applies only if it is the *plaintiff* making the allegation, not the defendant.
2. Under Central Bank (now Bangko Sentral) Circular 905, usury had been abolished in our country since Jan. 1, 1983. Interest will now depend on the mutual agreement of borrower and lender.
3. The provisions on usury allegations in the Rules of Court, being merely procedural, have been repealed, and this repeal has retroactive effect.

Art. 1176. The receipt of the principal by the creditor, without reservation with respect to the interest, shall give rise to the presumption that said interest has been paid.

The receipt of a later installment of a debt without reservation as to prior installment, shall likewise raise the presumption that such installments have been paid.

COMMENT:

(1) Example of Par. 1 (Receipt of Principal Without Reservation as to Interest)

A creditor of P1,000,000, with 8% interest, received P1,000,000 in payment of the principal. Interest was *not* referred to in the payment. It is presumed that the 8% interest had already been previously paid. This is because under Art. 1253, Civil Code, payment of the *interest as a rule precedes* payment of the principal. (Of course, Art. 1176 establishes merely a *rebuttable*, not a conclusive presumption). (See *Hill v. Veloso*, 31 Phil. 160 and *Vda. de Ongsiaco v. Cabatuando*, L-10738, March 19, 1959). Thus, even if there is a receipt evidencing payment of the principal, the accumulated interest may in certain cases still be recovered. (See *Magdalena Estates, Inc. v. Rodriguez*, L-18411, Dec. 17, 1966).

(2) Example of Par. 2 (Receipt of a Later Installment)

If a creditor receives the fourth installment of a debt, it is understood that the first three installments have been paid.

(NOTE: If I pay my income tax this year, no presumption arises about my payment of the tax last year. Taxes payable by the year cannot be considered installments.)

[NOTE: The presumption in par. 2 is also rebuttable. (*Manila Trading & Supply Co. v. Medina*, L-16477, May 31, 1961).]

(NOTE: In *Manila Trading and Supply Co. v. Medina*, L-16477, May 31, 1961, it was ruled that for the presumption in par. 2, Art. 1176 to apply, it is *not* enough that the receipt for the installment paid be *dated*; it must also specify that the receipt is for the payment of a *particular installment* due, for example, on a *certain month*. Thus, if the date of the receipt is January, 1999, this fact alone by itself cannot justify the inference that the January installment had been paid. The receipt may have been for a *prior installment*.)

Art. 1177. The creditors, after having pursued the property in possession of the debtor to satisfy their claims, may exercise all the rights and bring all the actions of the latter for the same purpose, save those which are inherent in his person; they may also impugn the acts which the debtor may have done to defraud them.

COMMENT:**(1) Rights of Creditors**

- (a) exact payment.
- (b) exhaust debtor's properties, generally by *attachment* (except properties exempted by the law). (*See Art. 2236, Civil Code*).
- (c) *accion subrogatoria* (subrogatory action) — *i.e.*, exercise all *rights* and *actions except* those *inherent in the person* (like parental authority, right to revoke donations on ground of ingratitude, hold office, carry out an agency). This is

not remedy of *subrogation* referred to in the Chapter on Novation. (See 8 Manresa, p. 272).

- (d) *accion pauliana* (impugn or rescind acts or contracts done by the debtor to defraud the creditors). (See Arts. 1380 to 1389 of the Civil Code which deals with rescissible contracts.)

Example:

**Regalado v. Luchasingco and Co.
5 Phil. 625**

FACTS: *A* was a defendant in a civil case. He lost, and attachment was issued against his property. *B*, the winner, could not collect his claim because it was discovered that *A* had sold his warehouse to his son, *C*, after attachment had been issued on such property. *B*, who could not collect in any other way because *A* had no money, brought an action to rescind the contract allegedly made to defraud him. It was proved that:

- 1) Although the warehouse was worth P25,000, the son allegedly paid only P15,000 for it;
- 2) The son probably did not have the P15,000 or any other sum of importance with which to buy the said warehouse.

HELD: The transaction is fraudulent and since *B*, the creditor, cannot recover in any other way, the contract ought to be rescinded.

**Serrano v. Central Bank, et al.
L-30511, Feb. 14, 1980**

To recover time deposits plus interest from a distressed bank, the claim must be ventilated in the Court of First Instance (now Regional Trial Court) in the proper action, but this action should not be one for *mandamus* or prohibition.

In the concurring opinion, however, of Justices Ramon Aquino and Antonio Barredo, the claim must be filed in the proper liquidation proceedings.

(2) Examples of Rights Inherent in the Person of the Debtor and Which Therefore Cannot Be Exercised by the Creditors

- (a) The right to existence, thereby exempting from the reach of creditors, whatever he may be receiving as support.
- (b) Rights or relations of a public character (like positions in the government).
- (c) Rights of an honorary character (like a doctor's degree, *honoris causa*).
- (d) Rights pertaining to the affairs of the home and the family (such as the personal rights of husband and wife).
- (e) Rights granted by law only to the debtor such as the action to revoke a donation on the ground of ingratitude. (*See 8 Manresa 116*).
- (f) The right to appear in court proceedings, like the settlement of an estate. (*In Re Estate of Ceballos, 12 Phil. 271*).

(3) Properties Exempt from Execution

Except as otherwise expressly provided by law, the following property, and no other, shall be exempt from execution:

- (a) The judgment obligor's family home as provided by law, or the homestead in which he resides, and land necessarily used in connection therewith;
- (b) Ordinary tools and implements personally used by him in his trade, employment, or livelihood;
- (c) Three horses, or three cows, or three carabaos, or other beasts of burden, such as the judgment obligor may select necessarily used by him in his ordinary occupation;
- (d) His necessary clothing and articles for ordinary personal use, excluding jewelry;
- (e) Household furniture and utensils necessary for housekeeping, and used for that purpose by the judgment obligor and his family, such as the judgment obligor may select, of a value not exceeding one hundred thousand pesos;
- (f) Provisions for individual or family use sufficient for four months;

- (g) The professional libraries and equipment of judges, lawyers, physicians, pharmacists, dentists, engineers, surveyors, clergymen, teachers, and other professionals, not exceeding three hundred thousand pesos in value;
- (h) One fishing boat and accessories not exceeding the total value of one hundred thousand pesos owned by a fisherman and by the lawful use of which he earns his livelihood;
- (i) So much of the salaries, wages, or earnings of the judgment obligor for his personal services within the four months preceding the levy as are necessary for the support of his family;
- (j) Lettered gravestones;
- (k) Monies, benefits, privileges, or annuities accruing or in any manner growing out of any life insurance;
- (l) The right to receive legal support, or money or property obtained as such support, or any pension or gratuity from the Government;
- (m) Properties specially exempted by law.

But no article or species of property mentioned in this section shall be exempt from execution issued upon a judgment recovered for its price or upon a judgment of foreclosure of a mortgage thereon. (*Sec. 13, Rule 39 of 1997 Rules of Civil Procedure*).

**Municipality of San Miguel v.
Hon. Oscar Fernandez
L-61744, Jun. 26, 1984**

The funds of a municipality should be regarded as public funds, and as such, are exempted from execution to satisfy a monetary judgment in a civil litigation.

(4) When Family Home Is Not Exempted from Attachment or Execution

- (a) *Judicial family home*

The family home, after its creation by virtue of judicial approval, shall be exempt from execution, forced sale, or attachment, *except*:

- 1) for non-payment of taxes (all kinds);
 - 2) in satisfaction of a judgment on a debt secured by a mortgage constituted on the immovable *before or after* the establishment of the family home. (*Art. 232, Civil Code*).
- (b) *Extrajudicial family home*

The family home *extrajudicially* formed shall be *exempt* from execution, forced sale, or attachment, *except*:

- 1) for non-payment of taxes (all kinds);
- 2) for debts incurred *before* the declaration was recorded in the Registry of Property;
- 3) for debts secured by mortgages on the premises before or after such record of the declaration;
- 4) for debts due to laborers, mechanics, architects, builders, materialmen and others who have rendered *service or furnished material* for the construction of the building. (*Art. 243, Civil Code*).

(5) Extent of Debtor's Liability

"The debtor is liable with all his property, present and future, for the fulfillment of his obligations subject to the exemptions provided by law." (*Art. 2236, Civil Code*).

Special Services Corporation v. Centro La Paz L-44100, Apr. 28, 1983

The court's power to enforce its judgment applies only to the properties which are *undisputably* owned by the judgment debtor.

(6) Right of the Creditor of an Insolvent Corporation

Eastern Shipping Lines, Inc. v. South Sea Exports, Inc., et al., Ricardo V. Alindayu and Adriano D. Isasos CA-GR 58883-R, Jul. 21, 1981

A creditor of an insolvent corporation can sue a subscriber thereto who has not completely paid for his subscription, pro-

vided such creditor sues not in his own private capacity, but in a representative capacity, that is, in behalf of the corporation. This is under the rationale that said unpaid subscription is an asset of the corporation and therefore within the reach, not of the suing creditor alone, but of all the various corporate creditors. A contrary rule would be unfair to all the other corporate creditors.

Art. 1178. Subject to the laws, all rights acquired in virtue of an obligation are transmissible, if there has been no stipulation to the contrary.

COMMENT:

(1) Transmissibility of Rights

- (a) *General rule* — Rights are transmissible.
- (b) *Exceptions*
 - 1) if the law provides otherwise;
 - 2) if the contract provides otherwise;
 - 3) if the obligation is purely personal.

[NOTE: Intransmissibility by contractual stipulation, being the exception to the rule, must be clearly proved. (See Estate of Hernandez v. Luzon Surety Co., L-8437, Nov. 28, 1956).]

(2) Non-Negotiable Promissory Note

Even if a promissory note is not negotiable, it may still be given, donated, or assigned to another. The effects will be governed not by the law on negotiation but by the law on assignment or donations. (*Gonzales v. Blas*, 3 Phil. 379). Payment can be made to transferee, provided he is in lawful possession of the credit. (*Azarraga v. Rodriguez*, 9 Phil. 637).

(3) Transfer of Rights from the Japanese to the Americans to the Filipinos

**Republic v. Emilio Guanzon
L-22374, Dec. 18, 1974**

FACTS: Emilio Guanzon borrowed money from the Bank of Taiwan during the Japanese occupation. Security was given

in the form of a real mortgage on two parcels, and a chattel mortgage on the crops growing on said parcels. When the Philippines was liberated in 1946, the mortgage credit was acquired by the United States, and later transferred to the Philippines thru the Philippine Property Act of 1946 (of the U.S. Congress, and therefore, a foreign law). The Philippines then files an action for foreclosure. The lower court dismissed the action, firstly, on the ground that the Philippines is not a party-in-interest (has no real legal interest in the mortgage loans), and secondly, on the ground that the foreign law cited cannot be taken judicial notice of, and resultantly, cannot be effective in our country.

HELD:

- (a) The Philippines has legal interest in the mortgage loans, because the mortgage credit was transferred to our government by the U.S. thru the Philippine Property Act of 1946 (a foreign law duly acquiesced in by both the executive and legislative branches of our government). (*Brownell, Jr. v. Sun Life Assurance Co.*, 95 Phil. 228 [1954].)
- (b) Because of such consent, said foreign law can be taken judicial notice of, and therefore can be given effect in our country.

(4) Assignment by a Guarantor

**Co Bun Chun v. Overseas Bank of Manila
L-27342, May 24, 1984**

When a person with a time deposit assigns the same to the bank to guarantee the debts or overdrafts of others, the assignor is NOT a mere guarantor. He is bound by all the terms included in the assignment.

Chapter 3

DIFFERENT KINDS OF OBLIGATIONS

Classification of Obligations

- (a) According to the PRIMARY classification of the Civil Code:
 - 1) *pure* as distinguished from *conditional*
 - 2) *pure* as distinguished from that *with a period or term*
 - 3) *alternative or facultative* obligations (as distinguished from *conjunctive*)
 - 4) *joint* as distinguished from *solidary*
 - 5) *divisible* as distinguished from *indivisible*
 - 6) with a *penal* clause (as distinguished from those without)
- (b) SECONDARY classification by the Civil Code:
 - 1) *unilateral* as distinguished from *bilateral* (Arts. 1168, 1191).
 - 2) real and personal (Arts. 1164-1165).
 - 3) determinate and generic (Arts. 1167, 1168).
 - 4) positive and negative (See Arts. 1167, 1168).
 - 5) legal, conventional, penal (Arts. 1156, 1158, 1159, 1161).
 - 6) civil and natural.
- (c) According to Sanchez Roman, IV, 20-24:
 - 1) according to juridical quality and efficaciousness
 - a) natural — according to natural law
 - b) civil — according to civil law

- c) mixed — according to both natural and civil laws
- 2) by the parties or subjects
 - a) unilateral, bilateral
 - b) individual, collective
 - c) joint, solidary
- 3) by the object of the obligation
 - a) specific, generic
 - b) positive, negative
 - c) real, personal
 - d) possible, impossible
 - e) divisible, indivisible
 - f) principal, accessory
 - g) simple, compound

[If compound — may be

 - (1) conjunctive — demandable at the same time
 - (2) distributive — either alternative or facultative]
- (d) Classification by the Code according to Defects:
 - 1) No defect — valid
 - 2) Defective
 - a) rescissible
 - b) voidable
 - c) unenforceable
 - d) void

**Rogales v. Intermediate Appellate Court
L-65022, Jan. 31, 1984**

Compulsory reference to the barangay courts on the proper cases IS NOT jurisdictional, although it generally is a condition to litigation.

Lack of reference affects only a party's cause of action. Thus, objection to the lack of a stated cause of action is deemed waived if not raised.

Section 1

PURE AND CONDITIONAL OBLIGATIONS

Art. 1179. Every obligation whose performance does not depend upon a future or uncertain event, or upon a past event unknown to the parties, is demandable at once.

Every obligation which contains a resolutive condition shall also be demandable, without prejudice to the effects of the happening of the event.

COMMENT:

- (1) Pure Obligation** — one *without* a condition or a term (hence, *demandable at once*, provided there will be *no absurdity*).

Examples:

- (a) I promise to pay you P1 million. [This is demandable *at once*, unless a period was really intended, as when a loan has just been contracted (*See Floriano v. Delgado, 11 Phil. 154*), or when some time is reasonably necessary for the actual fulfillment of the obligation, as when a person binds himself to pay *immediately* for the subscription of corporate shares of stock. (*Paul Schenker v. William F. Gemperle, L-16449, Aug. 31, 1962*).]
- (b) "I'll pay you P1 million on demand." (*See Abarri, Inc. v. Galan, 47 O.G. 6241*). But instant performance is not a necessity, otherwise absurd consequences will arise. (*8 Manresa 172*).
- (c) When the *original* period or *condition* has been cancelled by the mutual stipulation of both parties. (*See Estate of Mota v. Serram, 47 Phil. 464*).

- (2) Conditional Obligation** — when there is a condition.

Example:

- (a) I'll buy your land for P10 million if you pass the last bar

examinations. (This is *suspensive* for the results will be awaited).

- (b) I'll give you my land now, but should you fail in the last bar examinations, your ownership will cease and it will be mine again. (This is *resolutive* because it ends upon *failure*.).

(3) Definition of Condition

“It is an uncertain event which wields an influence on a legal relationship.” — *Manresa*.

(4) Definition of a Term or Period

That which necessarily must come (*like 2005*) whether the parties know *when* it will happen or not (*like death*, since this is *sure*).

(NOTE: Death because of S.A.R.S. is a *condition*, since death may be due to other causes.)

Example: “I’ll pay you P1 Million on *Jun. 1, 2005*.”

(5) When an Obligation Is Demandable at Once

- (a) When it is *pure*;
- (b) Or when it has a *resolutive condition*.

(*Example*: I’ll give you my car, but you should not marry Maria this year.) (This is demandable NOW.)

(NOTE: If the obligation is worded this way — “I’ll give you my car, but only *after* you can prove that by the end of this year, you have not married Maria” — this is *suspensive*, because the end of the testing period must be awaited.)

(6) Past Event Unknown to the Parties

This is not exactly a condition since, as a matter of reality, the thing has *already happened* or *not*. What is really meant here is, *future knowledge of a past event* will determine whether or not an obligation will arise. (*See 8 Manresa 120-121*). Hence,

a condition is really “a future AND certain event,” not “a future OR uncertain event.” (*J.B.L. Reyes, Observation on the New Civil Code, Lawyer’s Journal, Jan. 31, 1951, p. 47*).

(7) Classification of Conditions

- (a) — 1) *suspensive* — the happening of the condition gives rise to the obligation.
2) *resolutory* — the happening of the condition extinguishes the obligation.
- (b) — 1) *potestative* — depends upon the will of the debtor (*Example: I’ll sell you my car if I like.*)
2) *casual* — depends on chance or hazard or the will of a third person (if I win in the lotto).
3) *mixed* — depends partly on the will of one of the parties and partly on chance or the will of a third person (if I pass the bar).
- (c) — 1) *divisible* (capable of partial performance).
2) *indivisible* (not capable of partial performance because of the nature of the thing, or because of the intention of the parties).
- (d) — 1) *positive* — an act is to be performed.
2) *negative* — something will be omitted.
- (e) — 1) *express* — the condition is stated.
2) *implied* — the condition merely inferred.
- (f) — 1) *possible* — capable of fulfillment in nature and in law.
2) *impossible* — not capable of fulfillment due to nature or due to the operation of the law or morals or public policy; or due to a contradiction in its terms.
- (g) — 1) *conjunctive* — if all the conditions must be performed.
2) *alternative* — if only a few of the conditions have to be performed. (*See 8 Manresa 130*).

Art. 1180. When the debtor binds himself to pay when his means permit him to do so, the obligation shall be deemed to be one with a period, subject to the provisions of Article 1197.

COMMENT:

(1) Debtor to Pay “When His Means Permit”

Although it may *seem* that Art. 1180 speaks of a condition dependent exclusively on the will of the debtor (and therefore apparently VOID under Art. 1182), the fact remains *that payment does not depend on debtor’s will*, for indeed he had promised payment. What depends really on him is not payment, but the *TIME* when payment is to be made. Hence, the law under Art. 1180 considers this obligation as *one with a TERM or PERIOD*.

(2) Similar Phrases

- (a) “when my means permit to do so”;
- (b) “when I can afford it”;
- (c) “when I am able to”;
- (d) “when I have money,” *etc.*

(3) How Long Is the Term?

It is obvious that to leave the same to the discretion of either creditor or debtor would be unjust, therefore, Art. 1197 should be applied, *where the Court is obliged to fix the duration of the period*. The general rule is, therefore, for the creditor to ask the court *first* for the fixing of the term, and it is only when that term set arrives that he can demand fulfillment. Any action to recover before this is done is considered *premature*. (*Patente v. Omega*, 93 Phil. 218). In said *Patente* case, the phrase was “as soon as possible or as soon as I have money.” The only case when the bringing of the action to enforce, before the court fixes the term, *would be allowed* is when the prior action of fixing the term would serve no purpose but delay. (*Tiglao, et al. v. Manila Railroad Co.*, 98 Phil. 181).

Art. 1181. In conditional obligations, the acquisition of rights, as well as the extinguishment or loss of those already acquired, shall depend upon the happening of the event which constitutes the condition.

COMMENT:

(1) Suspensive and Resolutive Conditions

This Article treats of:

- (a) *suspensive conditions* — the happening of which will give rise to the acquisition of a right (also called *conditions precedent* or *conditions antecedent*). Be it noted that what characterizes an obligation with a suspensive condition is the fact that its efficacy or obligatory force is subordinated to the happening of a *future and uncertain event*; if the suspensive condition does not take place, the parties would stand as if the conditional obligation had never existed. (*Gaite v. Fonacier, L-11827, Jul. 31, 1961, 2 SCRA 831*).

Examples:

- 1) “I promise to do what you ask provided that *X* condition is first complied with.” (*See Phil. Nat. Bank v. Phil. Trust Co., 68 Phil. 48*).
- 2) *A*, in his will, gave some property to *B*, provided that *A* would die *within* a certain period. *A* did not die during said period. Since the suspensive condition was not complied with, *B* is not entitled to inherit. (*Natividad v. Gabino, 36 Phil. 663*).
- 3) If in a judgment by a court it is stated that unless a bond is given, the judgment can be enforced even while it is still on appeal, the giving of the bond should be considered as partaking of the nature of a suspensive condition. If the bond be not given, enforcement or execution can issue. (*See Santos v. Mojica, L-24266, Jan. 24, 1964*).

**Bengson v. Chan
78 SCRA 113**

ISSUE: If a contract provides for arbitration prior to recourse to courts but the case was filed without such needed arbitration, should the case be dismissed?

HELD: No, for the remedy should be to suspend the case until after arbitration is resorted to. (*See also R.A. No. 876, otherwise known as the Arbitration Law*).

San Miguel v. Elbinias
L-48210, Jan. 31, 1984

Before the writ of preliminary injunction can be granted, the posting of a bond (to answer for consequent damages) is a *condition sine qua non* (indispensable suspensive condition or condition precedent).

**Agapito Gutierrez v. Capital Insurance
and Surety Co.**
L-26827, Jun. 29, 1984

If the insurance contract stipulates that the driver of an insured car must be the owner of a valid and subsisting license, and at the time of the accident the driver had an *expired* license, the insurance company would not be liable.

Integrated Construction v. Relova
GR 41117, Dec. 29, 1986

FACTS: A decision-award by an arbitration board ordered the Metropolitan Waterworks and Sewerage System (MWSS) to pay Integrated Construction P13,188.50. Later, Integrated agreed to give MWSS some discounts provided MWSS would pay the amount on Oct. 17, 1972. MWSS, however, paid only on Dec. 22, 1972, the amount stated in the decision less the reductions. Three years later, Integrated moved for execution against MWSS for the balance due under the decision-award. MWSS opposed the execution setting forth the defense of payment. The judge denied the execution on the ground that the parties had novated the award by their subsequent agreement.

HELD: While the tenor of the subsequent agreement in a sense novates the judgment award there being a shortening of the period within which to pay, the suspensive

and conditional nature of the said agreement (making the novation conditional) is acknowledged by MWSS. Its failure to pay within the stipulated period removed the very cause for the agreement, rendering the same ineffective and, therefore, the parties were remitted to their original rights under the judgment award.

- (b) *resolutory conditions* — (also called conditions subsequent) — here, rights already acquired are lost once the condition is fulfilled.

Example:

- 1) I'll give you my car now but should you pass the bar, the donation will not be effective. If you pass the bar, you must return the car to me.

Parks v. Prov. of Tarlac
49 Phil. 142

FACTS: Concepcion Cirir and James Hill donated land to the province of Tarlac on condition that the latter would build upon the land a schoolhouse and a park, the work to begin within 6 months from the date the parties ratify the donation. The province accepted the donation, and the land was registered in the name of the donee. Several years later, noticing that the province had not performed the conditions, the donors sold the land to Mr. Parks. Now Parks sued to recover the land from the province.

HELD: Parks has no right to get the land. It is true that the donation was *revocable* because of breach of the conditions. But *until* the donation was revoked, it remained valid, and hence, Cirir and Hill had no right to sell the land to Parks. One cannot give what he does not have (*nemo dat quod non habet*). What the donors should have done first was to have the donation annulled. And after that was done, they could validly have disposed of the land in favor of Parks.

But there is *one more point* to be answered. The donors contend that the condition set forth — the

construction — was in the nature of a suspensive condition (*condition precedent*), that is, since the condition never happened, there really was no donation, and if there was no *donation*, there is no donation to be annulled. Hence, the donors insist on their right to sell the property to Parks. Are the donors correct here?

HELD: No. The condition imposed was not a condition precedent. It is *not true* that the schoolhouse and the park had to be constructed before the donation became effective, that is, before the province could become the owner of the land; otherwise, it would be invading the property rights of the donors. Hence, the donation had to become valid *even before* the fulfillment of the condition. Hence, the condition is a *resolutive one*. Inasmuch as although revocable, the donation had not yet been revoked, it follows that in the meantime, it is valid and, therefore, the sale by the donors to Parks is not valid. Hence, Parks has no right to recover the property.

[*Author's Note*: It is submitted that it is *not correct* to say that one has to be first the owner of the land before he can be allowed to build on it. One can very well do so upon the owner's permission, and it is evident that in this case, the owners (the donors) were already granting permission.]

(2) Conditional Perfection of a Contract

If the perfection of a contract depends upon the fulfillment of a condition, non-fulfillment thereof means the *non-perfection* of the contract since the suspensive condition should have been first fulfilled. (*Ruperto v. Kosca*, 26 *Phil.* 227).

(3) Some Cases and Doctrines

Panganiban v. Batangas Trans. Co. (C.A.) 46 O.G. 3167

FACTS: The Batangas Transportation Company bound itself to furnish a certain number of trucks *provided* they were

available on the day needed. On said day no truck was available.
Issue: Was the Company bound still to supply the trucks?

HELD: The Company never incurred the obligation since the condition did not materialize.

**Paulo Ang, et al. v. Furton Fire Insurance Co.
L-15862, Jul. 31, 1961**

A condition contained in an insurance policy that claims must be presented within one year after rejection is *not merely* a procedural requirement, but in the nature of a condition precedent to the liability of the insurer, or in other words, a resolutory clause, the purpose of which is to terminate all liabilities in case the action is not filed by the insured within the period stipulated.

**Luzon Stevedoring Corporation v. CIR
L-17411, 18681 and 18683, Dec. 31, 1965**

A Christmas bonus is NOT a demandable and enforceable obligation unless it is made a part of the wage or salary or compensation and even then the bonus would be CONTINGENT, dependent on the realization of profits. If there be no profits, there will be no *bonus*.

**Bengson v. Chan
L-27283, Jul. 29, 1977**

FACTS: In a contract for the construction of a condominium building, it was expressly agreed that should there be any dispute, a board of arbitrators must first be resorted to before taking any judicial action. The owner went to court because the building was not finished on time, but there was no prior resort to arbitration. *Issue:* Will the case now be dismissed?

HELD: No, the case will not be dismissed, although there was no prior resort to arbitration. This is so because under the Arbitration Law (RA 876), in a case like this, what the Court should do is to refer the matter to the arbitrators who are supposed to be selected by the parties.

Luzon Surety Co., Inc. v. Quebrar
L-40617, Jan. 31, 1984

If a statute requires the putting up of a bond, it is understood that the conditions prescribed by the statute shall form part of the bond agreement.

San Miguel v. Elbinias
L-48210, Jan. 31, 1984

In fixing the amount of a bond for the grant of a preliminary injunction, two factors that may be considered are the market value of the property, and the possible resultant damage if it should turn out that the injunction should not have been granted.

Art. 1182. When the fulfillment of the condition depends upon the sole will of the debtor, the conditional obligation shall be void. If it depends upon chance or upon the will of a third person, the obligation shall take effect in conformity with the provisions of this Code.

COMMENT:

(1) Potestative, Casual, Mixed Conditions

This Article deals with three *kinds* of conditions:

- (a) *potestative* — depends on the *exclusive* will of one of the parties. (This is also called *facultative* condition.)
- (b) *casual* — depends on chance OR upon the will of a *third person*. [*Example: If I win in the lotto. (Valid)*]

(2) Potestative (Facultative) Condition

- (a) Potestative on the part of the *DEBTOR*:
 - 1) if also *suspensive* — both the condition and the obligation are VOID, for the obligation is really illusory.
[Example: I'll give you P1,000,000 next month if I live. (8 Manresa 131).]

2) if also *resolutory* — *valid*

[*Example*: I'll employ you now as my superintendent in the factory, but it is understood that if for *any reason* (including my own cancellation of the order) the machinery which I ordered from the United States will not arrive, the employment will end. (*Taylor v. Yu Tieng*, 43 Phil. 873, held that “a condition both *potestative* and *resolutory* may be valid even if the condition is made to depend upon the will of the obligor.”)]

[*NOTE*: It is submitted that although this is indeed a *resolutory condition* (because the order would be either *cancelled* or not), still it has the effect of a *resolutory term* (because the employee here would not be obliged to *return* wages for work already done).]

(b) Potestative on the part of the *CREDITOR* — *VALID*

Example: “I'll give you my fountain pen if *you* desire to have it.” (*See 8 Manresa 134-135*).

(3) **Query**

“I'll give you P1,000,000 if I *can sell my land*.” Suppose I am able to sell my land, am I bound to give you P1,000,000?

ANS.: It is submitted that the answer is *YES*. While *apparently*, this is a potestative condition (because I may or I may not sell) (*See Osmena v. Rama*, 14 Phil. 99 — which, in a similar case, held that such a stipulation is VOID), still it is *not purely potestative* (as distinguished from the *simply potestative*) but really a mixed one, because the selling would depend not only on my desire to sell but also on the availability and willingness of the buyer and other circumstances such as *price*, *friendship*, or the necessity of transferring to a different environment. (*See Hermoso v. Longara*, 49 O.G. 4287, Oct. 1953).

(4) **Cases**

Smith, Bell and Co. v. Sotelo Matti
44 Phil. 874

FACTS: A sold merchandise to B, said merchandise to be delivered in 3 months, but the period of delivery was not guar-

anteed. Although *A* tried his best to fulfill his commitments on time, still transportation and government red tape made delivery possible only *after* three months. Whereupon *B* refused to accept the goods and to pay for them on the ground that the term had *not* been complied with.

HELD: B should accept and pay, for there was really *no term* but a *mixed* condition. Considering that *A* had already tried his best, it is as if all the terms of the contract had been faithfully complied with, for here the fulfillment of the condition did not depend purely on his will but on others, like the shipping company and the government. *B* should now comply.

Jacinto v. Chua Leng
(C.A.) 45 O.G. 2919

FACTS: A owned a house rented by *B*. *A* sold the house to *C*, and *C* agreed to pay the balance of the price *as soon as B leaves the premises*. *C* was to take care of seeing to it that *B* vacated the house. *A* now says the contract is void because it is *potestative* on *C*'s part.

HELD: The contract is valid. It was not purely *potestative* on *C*'s part.

- (a) *Firstly* — *B* might vacate of his own accord, and *C* would now have to pay (so the fulfillment really in part depended on the will of a third party).
- (b) *Secondly* — If *C* did not ask *B* to leave, *A* could very well do so by an action of unlawful detainer against *B*. And when *B* is ousted, *C* would have to pay.

The condition being *mixed*, the contract is valid.

Trillana v. Quezon Colleges, Inc.
93 Phil. 383

FACTS: D purchased 200 shares of stock of the Quezon Colleges, subject to the condition that she would *pay* for the same as soon as she would be able to harvest fish from her fishpond.
Issue: Is this condition valid?

HELD: No, because this suspensive condition is purely potestative on her part.

Art. 1183. Impossible conditions, those contrary to good customs or public policy and those prohibited by law shall annul the obligation which depends upon them. If the obligation is divisible, that part thereof which is not affected by the impossible or unlawful condition shall be valid.

The condition not to do an impossible thing shall be considered as not having been agreed upon.

COMMENT:

(1) Impossible and Illegal Conditions

This Article deals with the effect of *impossible* and *illegal* conditions.

(2) Classification

- (a) *Impossible* [*physically* — to make a dead man live; — *logically* — to make a circle that is at the same time a square (*illogical condition*)].
- (b) *Illegal* [prohibited by good customs, public policy; prohibited, directly or indirectly, by law, like killing X, a friend].

(3) Effects

- (a) If the condition *is to do* an *impossible* or *illegal* thing, BOTH the condition and the obligation are VOID (because the debtor knows that no fulfillment can be done and therefore is not serious about being liable).

Example: I'll sell you my land if you can make a dead man live again.

- (b) If the condition is NEGATIVE, that is, *not to do* the *impossible*, just *disregard* the *condition* BUT the obligation remains.

Example: I'll sell you my land if you *cannot* make a *circle* that is at the same time a *square*. (This becomes a

pure and valid obligation. As a matter of fact, the condition here can always be fulfilled.)

- (c) If the condition is **NEGATIVE**, *i.e.*, *not* to do an *illegal* thing, *both* the *condition* and the *obligation* are **VALID**.

Example: I'll sell you my land if you *do not* kill X. (This is valid. If X is killed by you, you have no right to buy my land.)

[*NOTE:* The example given above applies only to obligations and contracts, not to *testamentary disposition* or to *donations*. In said case, the impossible or illegal condition is just disregarded, and the disposition or donation remains valid. (*See Arts. 873 and 727, Civil Code*).]

(*NOTE:* This is because in said cases, it is really the *liberality* of the giver that is the consideration of the gift.)

(4) Some Cases

Santos v. Sec. of Agriculture and Natural Resources and Director of Lands 91 Phil. 832

The duty of a successful bidder to make a construction within one and one-half years from the award is extinguished, if because of the confiscation of his materials by the Japanese army, the work has become physically impossible.

Luneta Motor Co. v. Federico Abad 67 Phil. 23

FACTS: A filed a suit against B, and asked for a writ to attach B's properties. The writ was granted, but B asked for its cancellation, and for this purpose offered a bond, secured by two sureties. The bond contained a statement that in case A should WIN, the sureties would answer for B's liability. Because of this bond, the writ was dissolved. Later, A lost the case, it having been *dismissed*. *Issue:* Are B's sureties still bound?

HELD: No more, because A can never win, the case having been dismissed. The condition has become a legal impossibility.

Litton, et al. v. Luzon Surety, Inc.
90 Phil. 783

FACTS: Seller owned a piece of land mortgaged to X. Land was sold to buyer on the condition that the mortgage would first be cancelled. Seller, however, could not have contact with X.
Issue: Is he still bound to sell?

HELD: No, since the condition has become impossible.

Fieldman's Insurance Co., Inc. v. Mercedes
Vargas Vda. de Songco and the Court of Appeals
L-24833, Sept. 23, 1968

If some conditions in a contract are impossible to comply with, the insurer cannot validly assert a breach of said conditions.

Art. 1184. The condition that some event happen at a determinate time shall extinguish the obligation as soon as the time expires or if it has become indubitable that the event will not take place.

COMMENT:

(1) Positive Conditions

This Article deals with *positive* conditions.

Example: I'll give you my land if you marry Maria X this year. If by the end of the year, Maria X is already dead, or you have not yet married her, the obligation is extinguished.

Addison v. Felix
38 Phil. 404

FACTS: A bought B's land on condition that within a certain period, B would obtain a Torrens Title. B did not do so within the stipulated term.

HELD: A is released from his obligation to purchase.

(2) Effect if Period of Fulfillment Is Not Fixed

If the period is not fixed in the contract, the court, considering the parties' intentions, should determine what period was really intended. (*See Art. 1185, par. 2, Civil Code*).

Martin v. Boyero
55 Phil. 760

FACTS: A sold B a parcel of land on condition that the price would be paid as soon as B had paid off the mortgage and other debts of the estate. A waited for some time, but since B had not yet succeeded in paying off the debts, A brought an action to cancel the sale.

HELD: The sale will not be cancelled. There was no time stipulated here, and besides, B was trying his best to comply with his agreement. So B must be given more time.

Art. 1185. The condition that some event will not happen at a determinate time shall render the obligation effective from the moment the time indicated has elapsed, or if it has become evident that the event cannot occur.

If no time has been fixed, the condition shall be deemed fulfilled at such time as may have probably been contemplated, bearing in mind the nature of the obligation.

COMMENT:**(1) Negative Conditions**

This Article refers to negative conditions.

(2) Example

"I'll give you P1,000,000 if by Oct. 1, 2005 you have not yet married Maria X." If by said date, you are not yet married, or if prior thereto, Maria X had died, the obligation is effective — in the *first* case, from Oct. 1, 2005; and in the second case, from Maria's death.

Query: Suppose before that date, you become a Roman Catholic priest, is the obligation effective on the date you entered

the priesthood? No, because some priests, despite religious vows, still contract *legally valid* marriages.

Art. 1186. The condition shall be deemed fulfilled when the obligor voluntarily prevents its fulfillment.

COMMENT:

(1) Rule When Debtor Voluntarily Prevents Fulfillment of the Condition

This Article deals with CONSTRUCTIVE OR PRESUMED FULFILLMENT. *Reason for the Article:* One must not profit by his own fault.

(2) Requisites

- (a) VOLUNTARILY made — (Either maliciously or not, the intent to *prevent* must be present.) (*8 Manresa 137*). (If done voluntarily for another purpose, this requisite is not present).
- (b) actually PREVENTS — (Intention without prevention, or prevention without intention is not sufficient.) (*8 Manresa 138*). [But *intention* and *prevention* in the exercise of a *lawful right* will not render the Article applicable. (*3 Salvat 316*).]

(3) Example

A promised to sell to *B* a car if *C* could pass the bar. On the day of the examination, *A* caused *C* to be poisoned and be hospitalized. *A* is still bound to sell the car. (If, however, it turns out that *C* was really disqualified to take the bar, as when he *had not finished high school*, or had taken his first year law in the prohibited *special class*, *A* is not bound.)

(4) Cases

**Labayen v. Talisay
52 Phil. 440**

FACTS: *A* was a *hacienda* owner who contracted the services of *B*, a sugar central, to grind his (*A*'s) sugar cane. For

this purpose, *A* was supposed to allow *B* to construct a railroad through *A*'s *hacienda*. But *A* did not give permission for the construction. Yet he sued *B* for failure to grind the sugar cane. *Issue*: Should *A*'s action prosper?

HELD: No, for he had voluntarily prevented compliance by failing to allow construction.

Valencia v. RFC
L-10749, Apr. 25, 1958

FACTS: Valencia bid for the installation of the plumbing in a government building. The bid was accepted, and Valencia was asked to put up the *performance bond*. Valencia did not put up the bond and did not begin the work. When sued, his defense was that since he did not put up the bond, there was *no* contract since the condition was not complied with.

HELD: Valencia is liable. *Firstly*, the putting up of the performance bond was *not* a condition before he could be compelled to make the installation, although of course it was a condition before he could insist on working and on getting paid. *Secondly*, assuming that the condition was indeed conditional, it was he who *voluntarily* prevented its fulfillment; therefore, he can be held liable.

Mana v. Luzon Consolidated Mines & Co.
(C.A.) 40 O.G. (4th Series) 129

FACTS: *A* hired *B* to construct a road for him up to a desired length. But without justification, *A* ordered the construction stopped when half-finished. *B* asked for the *complete price*. *A* refused on the ground that the project was only half-finished.

HELD: *A* should pay in full, for it was he who voluntarily prevented fulfillment of the condition — the construction of the entire road — and so it is as if the work had been completed.

Taylor v. Yu Tieng Piao
43 Phil. 873

FACTS: *A* employed *B* for 2 years unless within 6 months, machinery already ordered would not, for any reason, arrive. *A*

cancelled the order, so the machines did not arrive. At the end of six months *B* was discharged. *B* now claims salary for the period of two years on the ground that the debtor (*A*) had voluntarily prevented compliance with the condition.

HELD: B has no right. *First*, because the condition here is *resolutive* and *not suspensive*; *second*, it was expressly agreed that the failure to arrive could be for “any reason,” including *A*’s own acts. Ordinary words should be given their ordinary significations, unless the parties intended otherwise.

(5) Applicability of the Article to Resolutive Conditions

Although in general, Art. 1186 applies only to a suspensive condition, it may *sometimes* apply to a resolutive condition as in this case:

A sold land now to *B* on condition that *B* marries *C* within one year, otherwise *B* should *return* the land. If *A* kills *C*, *B* does *not* have to return the land. This is because *A* is at fault. (*See by analogy TS, March 17, 1941*).

Art. 1187. The effects of a conditional obligation to give, once the condition has been fulfilled, shall retroact to the day of the constitution of the obligation. Nevertheless, when the obligation imposes reciprocal prestations upon the parties, the fruits and interests during the pendency of the condition shall be deemed to have been mutually compensated. If the obligation is unilateral, the debtor shall appropriate the fruits and interests received, unless from the nature and circumstances of the obligation it should be inferred that the intention of the person constituting the same was different.

In obligations to do and not to do, the courts shall determine, in each case, the retroactive effect of the condition that has been complied with.

COMMENT:

(1) Effects of Fulfillment of Suspensive Conditions

The obligation becomes *effective*.

From what day?

- (a) RETROACTS — (as a *general rule*) to the day the obligation was constituted.
- (b) No *retroactivity with reference only to*:
 - 1) fruits or interests. (*Art. 1187, Civil Code*).
 - 2) period of prescription. (*Hermosa case, GR L-5267, Oct. 27, 1953*). Here the period runs from the day the condition was *fulfilled*, because it can be enforced only from said date.

(2) Examples of Retroactive Effects

Jose in 2004 promised to sell to Maria his land provided Maria passes the bar in 2006. Maria passed the bar in 2006.

- (a) It is as if Maria was entitled to the land *beginning 2004*.
- (b) Therefore —
 - 1) any *donation* or *mortgage* made by Maria in 2004 (before passing) will be considered valid. (Under the law of donations, future property cannot as a rule be donated, but inasmuch as Maria is entitled to the land effective 2004, it follows that the *property cannot* be considered a *future one*. The same is true with regard to a mortgage, for under the law, the mortgagor must be the owner). (These are acts *pendente conditionae*.)
 - 2) any alienation on the land made by Jose (*pendente conditionae*) should *as a rule* be considered *invalid*.

[NOTE: This retroactive effect can apply only to CONSENSUAL contracts (like *sale*), and *not* to *real* contracts (such as deposit or *commodatum*), which are perfected only upon delivery.]

(3) No Retroactive Effects as to Fruits and Interests

- (a) In *unilateral* obligations, debtor gets the fruits and interests unless there is a contrary intent.

Example: In 2005, A promised to give B his (A's) land if B passes the bar in 2006. If the condition is fulfilled,

does *A* also give the fruits for the period of one year? NO, by express provision of the law unless there is a contrary intent.

- (b) In *reciprocal* obligations, the fruits and interests during the pendency of the condition shall (for the purpose of convenience and practical effectiveness) be deemed to compensate each other (even though they really be unequal).

Example: In 1999, *A* agreed to sell *B* his land and *B* agreed to pay if *C* passes the bar of 2006. *C* passed. *A* must now give the land, and *B* must pay. The fruits of the land for the one-year period will remain with *A*, *i.e.*, *A* does not have to give said fruits. Upon the other hand, *B* will keep the 6% legal interest on his money. This is true even if the interests be greater or lesser than the fruits.

(4) Scope of “Fruits”

“Fruits” here refer to natural, industrial, and civil fruits (like rent). (*See Art. 442, Civil Code*).

Art. 1188. The creditor may, before the fulfillment of the condition, bring the appropriate actions for the preservation of his right.

The debtor may recover what during the same time he has paid by mistake in case of a suspensive condition.

COMMENT:

(1) First Paragraph (Actions to Preserve Creditor’s Rights)

- (a) *Reason:* If not allowed to take the appropriate actions, there is a danger the creditor will receive nothing, as when the object is deliberately *destroyed*, or *hidden*, or *alienated*.
- (b) “*Bring appropriate actions.*” According to Justice J.B.L. Reyes, this means to *sue* in court. He says “take appropriate action” would be a better phrase, since this would include not only suits in court, but also such remedies as recording (of the expected right) with the Register of Deeds. (*See Lawyers’ Journal, Jan. 31, 1951, p. 47*).

Other appropriate actions:

- 1) ask for *security* if the debtor is about to be insolvent.
 - 2) ask the court to prevent alienation or concealment *pendente conditionae*.
- (c) “*Preservation.*” Note that the law says “preservation,” not “preference” over other creditor. (*Jacinto v. de Leon*, 51 Phil. 992).

Phil. Long Distance Telephone Co. v. Jeturian
L-7756, Jul. 30, 1955

FACTS: The Phil. Long Distance Telephone Co. operated a pension plan prior to the last Pacific War, whereby, subject to certain conditions (such as age and length of service), employees who retire would be given pensions. After the war, the plan was abolished because of losses sustained during the Japanese occupation.

ISSUES:

- (a) Pending fulfillment of the conditions (such as the employee’s service), do the employees have any right with respect to the pension plan?
- (b) Would financial losses during the war authorize abolition of the plan?

HELD:

- (a) Pending fulfillment of the conditions, the employees have a *right in expectancy*, which the law protects. Hence, under Art. 1188, appropriate actions may be taken by them.
- (b) Financial losses will *not excuse* abolition of the pension plan because the obligation to pay money is an obligation to give a **GENERIC** thing.

(2) Second Paragraph (Right of Debtor to Recover What Was Paid by Mistake)

- (a) *Reason:* What was paid by mistake may be recovered because, after all, the condition may not materialize. In the meantime, the debtor has lost the use of the object. It is

unfair for the creditor to unjustly enrich himself. This is a case of *SOLUTIO INDEBITI* (undue payment). The debtor is also *entitled* to fruits or legal interest if the creditor be in BAD FAITH, that is, if the creditor knew that payment was being made prior to the fulfillment of the condition.

- (b) If payment was not by “mistake” (that is, it was done deliberately), can there be recovery?

ANS.: It depends:

- 1) If the condition is fulfilled, no recovery because of *retroactivity* (already discussed).
- 2) If the condition is not *fulfilled*, there should be a recovery (for this would be unjust enrichment) unless a pure donation was intended.

Art. 1189. When the conditions have been imposed with the intention of suspending the efficacy of an obligation to give, the following rules shall be observed in case of the improvement, loss or deterioration of the thing during the pendency of the condition:

(1) If the thing is lost without the fault of the debtor, the obligation shall be extinguished;

(2) If the thing is lost through the fault of the debtor, he shall be obliged to pay damages; it is understood that the thing is lost when it perishes, or goes out of commerce, or disappears in such a way that its existence is unknown or it cannot be recovered;

(3) When the thing deteriorates without the fault of the debtor, the impairment is to be borne by the creditor;

(4) If it deteriorates through the fault of the debtor, the creditor may choose between the rescission of the obligation and its fulfillment, with indemnity for damages in either case;

(5) If the thing is improved by its nature, or by time, the improvement shall inure to the benefit of the creditor;

(6) If it is improved at the expense of the debtor, he shall have no other right than that granted to the usufructuary.

COMMENT:**(1) Loss, Deterioration, and Improvement During the Pendency of Condition**

- (a) The Article applies only if:
 - 1) the suspensive condition is *fulfilled*; and
 - 2) the object is specific (not generic).
- (b) What are the three things that may happen to the object of an obligation pending the fulfillment of a suspensive condition?

ANS.: The object:

- 1) may be lost
- 2) may deteriorate (value is reduced or impaired)
- 3) may be improved

The object may be *lost*:

- a) without the fault of the debtor
- b) with fault of the debtor
- c) partly with and partly without the fault of the debtor

The object may *deteriorate*:

- a) without the fault of the debtor
- b) with the fault of the debtor
- c) partly with and partly without the fault of the debtor

The object may *improve*:

- a) by nature or by time
- b) through the expense of the debtor
- c) partly through nature or time and partly by the debtor

(NOTE: Because of these varying circumstances, the Code has deemed it proper to enunciate several rules thereon, hence, the existence of Art. 1189.)

(2) “Loss” Defined

It is understood that the thing is lost:

- (a) *when it perishes* (as when a house is burnt to ashes)
- (b) *when it goes out of commerce* (as when the object heretofore unprohibited becomes prohibited)
- (c) *when it disappears in such a way that its existence is unknown* (as when a particular car has been missing for some time)
- (d) *when it disappears in such a way that it cannot be recovered* (as when a particular diamond ring is dropped in the middle of the Pacific Ocean). (*Art. 1189, par. 2, Civil Code*).

(3) Effects of Partial Loss

It may be partial loss:

- (a) that would *amount* to a loss important enough to be considered a *complete loss* (this will be determined by the courts). (*Art. 1263, Civil Code*).
- (b) that would merely be considered a *deterioration* of the thing, in which case the rules on *deterioration* should apply.

(4) Illustrative Problems

- (a) A promised to give *B* his car if *B* passes the bar. Pending the results of the bar exams, the car is destroyed by a fortuitous event, without any fault at all on the part of the debtor. When *B* passes the bar, does *A* have to give *B* anything?

ANS.: No, *A* does not have to give *B* anything. “If the thing is lost without the fault of the debtor, the obligation shall be extinguished.” (*1st par., Art. 1189, Civil Code*). The reason is that as a general rule, no one should be liable for a fortuitous event unless otherwise provided by law or contract.

- (b) *A* promised to give *B* P1,000,000 if *B* passes the bar. Pending the results of the bar, *A*’s money is destroyed by fire,

not imputable to A. When B passes the bar, does A still have to give him P1,000,000?

ANS.: Yes, because the money here is generic. “In an obligation to deliver a generic thing the loss or destruction of anything of the same kind does not extinguish the obligation.” (*Art. 1263, Civil Code*). The reason is “*Genus nunquam perit*” — “*genus never perishes*.”

- (c) Suppose the loss occurred through the fault of the debtor, is the debtor liable?

ANS.: Yes. “If the thing is lost through the fault of the debtor, he shall be obliged to pay damages.” (*Art. 1189, par. 2, Civil Code*).

- (d) Suppose pending the fulfillment of the suspensive condition, the object, say a particular car, deteriorates *without* the fault of the debtor, is the debtor bound to make up for the depreciation, or should the creditor bear the deterioration suffered?

ANS.: In such a case, the creditor will have to suffer the deterioration or impairment. The law says: “When the thing deteriorates without the fault of the debtor, the impairment is to be borne by the creditor.” (*Art. 1189, par. 3, Civil Code*).

- (e) Suppose the thing deteriorates through the fault of debtor?

ANS.: The creditor here may choose between:

- 1) *Rescission* (or cancellation of the agreement or obligation), *plus* damages;
 - 2) *Or fulfillment* of the obligation (even if there has been deterioration) *plus* damages. (*Art. 1189, par. 4, Civil Code*).
- (f) Suppose the thing is improved by nature or by time, who gets the benefit of the improvement?

ANS.: The creditor gets the benefit. “If the thing is improved by its nature or by time, the improvement shall inure (go) to the benefit of the creditor.” (*Art. 1189, par. 5,*

Civil Code). The reason for this is to compensate the creditor who would suffer in case, instead of improvement, there would be deterioration without the fault of the debtor.

- (g) Suppose the thing has improved, not through time or by its nature but through the expense of the debtor, what will be the rights of said debtor?

ANS.: The debtor will have the rights granted to a usufructuary for improvements on a thing held in usufruct. (Usufruct is the right to the enjoyment of the *use* and the *fruits* of a thing.) These rights granted to the usufructuary with reference to improvements may be found in Art. 579 of the Civil Code, which reads as follows: "The usufructuary may make on the property held in usufruct such useful improvements or expenses for mere pleasure as he may deem proper, provided he does not alter its form or substance; but he shall not have the right to be indemnified therefor. He may, however, remove such improvements, should it be possible to do so without damage to the property." In other words, he is not entitled to reimbursement but he may remove the improvements provided he does not, by doing so, damage the property. "He may however set off the improvements he may have made on the property against any damage to the same." (*Art. 580, Civil Code*).

- (h) Suppose the improvement is due partly to the expenses made by the debtor and partly due to its nature or by time, who gets the benefit?

ANS.: The creditor gets the benefit of the improvement of the thing by its nature or by time, but the debtor is entitled to the rights of a usufructuary over useful improvements that may have been caused at his expense.

(NOTE: The subject of usufruct is treated in detail in the subject "Property.")

Art. 1190. When the conditions have for their purpose the extinguishment of an obligation to give, the parties, upon the fulfillment of said conditions, shall return to each other what they have received.

In case of the loss, deterioration or improvement of the thing, the provisions which, with respect to the debtor, are laid down in the preceding article shall be applied to the party who is bound to return.

As for obligations to do and not to do, the provisions of the second paragraph of Article 1187 shall be observed as regards the effect of the extinguishment of the obligation.

COMMENT:

(1) Effects When Resolutive Condition Is Fulfilled

- (a) The obligation is extinguished. (*Art. 1181, Civil Code*).
- (b) Because the obligation had been extinguished and considered to have had no effect, the parties should restore to each other what they have received.
- (c) Aside from the actual things received, the fruits or the interests thereon should also be returned after deducting of course the expenses made for their production, gathering, and preservation. (*Art. 443, Civil Code*).
- (d) The rules given in Art. 1189 will apply to whoever has the duty to return in case of the loss, deterioration, or improvement of the thing.
- (e) The courts are given power to determine the retroactivity of the fulfillment of resolutive conditions.

(2) Problems

- (a) *A* gave *B* a parcel of land on the condition that *B* will never go to the casino. A month later, *B* went to the casino. What happens to *A*'s obligation?

ANS.: A's obligation is extinguished, and therefore it is as if there never was an obligation at all. B will therefore have to return both the land and the fruits he had received therefrom from the moment A had given him the land.

- (b) Suppose in the meantime, the land had been improved through its nature or by time, who benefits from such improvements?

ANS.: A gets the benefit because he is now the creditor with respect to the recovery of the land. (*Art. 1189, par. 5, Civil Code*).

Art. 1191. The power to rescind obligations is implied in reciprocal ones, in case one of the obligors should not comply with what is incumbent upon him.

The injured party may choose between the fulfillment and the rescission of the obligation, with the payment of damages in either case. He may also seek rescission, even after he has chosen fulfillment, if the latter should become impossible.

The court shall decree the rescission claimed, unless there be just cause authorizing the fixing of a period.

This is understood to be without prejudice to the rights of third persons who have acquired the thing, in accordance with Articles 1385 and 1388 and the Mortgage Law.

COMMENT:

(1) Right to Rescind

“The power to *rescind*,” as used in this Article, means the right to *cancel* (or *resolve*) the contract or *reciprocal obligations* in case of non-fulfillment on the part of one. Thus, the “rescission” referred to here is not predicated on injury to economic interests on the part of the party plaintiff (which is the basis for the rescission mentioned in *Arts. 1380 and 1381, Civil Code*), but on the *breach of faith* by the defendant, which breach is violative of the reciprocity between the parties. (*Universal Food Corporation v. Court of Appeals, L-29155, May 13, 1970*).

**Spouses Mariano Z. Velarde & Avelina D.
Velarde v. CA, David A. Raymundo, &
George Raymundo
GR 108346, Jul. 11, 2001**

FACTS: Petitioners failed to comply with their obligation to pay the balance of the purchase price to private respondents.

Issue: Because of the failure, were private respondents correct in validly exercising their right to rescind the contract?

HELD: Yes. Indubitably, petitioners violated the very essence of reciprocity in the contract of sale, a violation that consequently gave rise to private respondents' right to rescind the same in accordance with law. Stated in another modality, a substantial breach of a reciprocal obligation, like failure to pay the price in the manner prescribed by the contract, entitles the injured party to rescind the obligation. Rescission abrogates the contract from its inception and requires a mutual restitution of benefits received.

Rescission creates the obligation to return the object of the contract. It can be carried out only when the one who demands rescission can return whatever he may be obliged to restore. (*Co. v. CA, 312 SCRA 528 [1999]*). To rescind is to declare a contract void at its inception and to put an end to it as though it never was. It is not merely to terminate it and release the parties from further obligations to each other, but to abrogate it from the beginning and restore the parties to their relative positions as if no contract has been made. (*Ocampo v. CA, 233 SCRA 551 [1994]*).

(2) Reciprocal Obligations

This Article in speaking of "reciprocal ones" refers only to *reciprocal obligations*, that is, to obligations where two parties are reciprocally obliged to do or give something. (*Example: contract of sale*). It is not enough that both parties are indebted to each other. The cause must be IDENTICAL and the obligations should arise simultaneously. (*See 8 Manresa 255*). Parenthetically, in reciprocal contracts or transactions, the obligation or promise of each party is the *cause* or *consideration* for the obligation or promise of the other. (*Vda. de Quirino v. Palarca, L-28269, Aug. 15, 1969*).

Aspon Simon v. Adamos L-39378, Aug. 28, 1984

In an action to rescind or for specific performance, the latter was granted, but the same later became impossible (in view of

the cancellation of certain titles). May the remedy of rescission still be granted? Yes, under Art. 1191 of the Civil Code, since specific performance has now become impossible — because the titles of the lots (formerly in the name of the defendants) have already been nullified or cancelled, so that defendants can no longer deliver their ownership to plaintiffs.

**DMRC Enterprise v. Este del Sol
Mountain Reserve
GR 57936, Sept. 26, 1984**

If a lessee agrees with his lessor to pay rent partly in corporate shares, it is the regular courts (not the Securities and Exchange Commission) that has jurisdiction over a complaint for specific performance and delivery of personal property. There is no intra-corporate controversy. The mere fact that the lessor also wants to be regarded as a stockholder is immaterial. In fact, this desire merely indicates that the lessor is *not* yet a stockholder.

(3) Examples

- (a) In a contract of sale, the buyer can rescind if the seller does not deliver, or the seller can rescind if the buyer does not pay. (This is all right for this is a reciprocal obligation.)
- (b) A borrowed P1,000,000 from *B* as a loan. *A*, on the other hand, is the owner of a garage where *B* *deposits* (for safe-keeping) his car. *B* owes *A* P1,000,000 for deposit fees. Is this a reciprocal obligation? No. Although they are *mutually* bound, the cause does not arise from the same contract. One is the contract of loan; the other is the contract of deposit. The payment of P1,000,000 as a loan does not depend on the payment of P1,000,000 as deposit fees.

(NOTE: In the above case of deposit, which incidentally is, by *itself*, a reciprocal obligation, the *duty to pay deposit fees* has its reciprocal counterpart in the *duty to safely keep* the car.)

**Asturias Sugar Central v.
Pure Cane Molasses Co.
60 Phil. 255**

FACTS: A sold to B some properties. It was agreed that B, the buyer, should take care of perfecting within 6 months the title papers to the property. This duty B was not able to do. *Issue:* Despite the fact that B has already paid the price, may A, the seller, resolve the contract on the ground that B had not complied with the obligation referred to above?

HELD: No. In a case of sale, the corresponding duties are: for the *seller to deliver*, and for the *buyer to pay*. Here the buyer has paid. Therefore, the *seller cannot resolve* just because the title papers had not yet been perfected. Had the buyer not yet paid, it would have been a different story. (*See also Borromeo v. Franco, 5 Phil. 49*).

**Abaya v. Standard Vacuum Oil Co.
L-9511, Aug. 30, 1957**

If the parties enter into an agreement that the plaintiff will be appointed as operator of a gasoline station, provided that he signs an operator's agreement requiring him to purchase 150,000 liters of gasoline monthly from the defendant, but the plaintiff refuses to sign said agreement, the defendant is absolved from its obligation. The reason is simple. In reciprocal obligations, the performance of one is conditioned on the simultaneous fulfillment of the other.

**Pio Barreto Sons, Inc. v. Compania Maritima
L-22358, Jan. 29, 1975**

FACTS: A lumber company sued to collect a certain amount from a customer as payment for lumber purchased on credit. The CFI (now RTC) decided in favor of the lumber company, but the CA reversed the CFI (RTC) on the ground that the *delivery* of the lumber had not been proved. It is now contended by the lumber company that the CA should not have touched on the *issue of delivery*, because the issue touched upon by the CFI (RTC) was the issue of *whether or not payment had been made*. *Issue:* Should the issue of delivery be touched upon?

HELD: Yes, the issue of delivery should be touched upon because *delivery* and *payment* in a contract of sale are so inter-related that in the absence of delivery of the goods, there is generally no corresponding obligation yet for the buyer to pay. (See Art. 1458, par. 1, Civil Code).

Santiago v. Gonzales
L-36627, Oct. 20, 1977

FACTS: The building contractor in a construction contract, not having been paid properly for the work, decided to stop the construction and to cancel or rescind the contract. As a result of the rescission, both parties agreed to submit the dispute to an Arbitration Board. After the necessary hearing and reception of evidence, the Board awarded nearly P50,000 to the contractor as the price still owing him. Not satisfied with the arbitral verdict, the owner went to the CFI (RTC), which, without receiving any additional evidence, rendered a decision stating that the arbitral award was proper. The owner then filed a motion for reconsideration but failed to indicate in what way the judgment contravened either the law or the evidence. *Issue:* Should the verdict of the trial court be sustained?

HELD: Yes, because the owner had sufficient opportunity to present his side before the duly constituted Arbitration Board. Otherwise stated, there was no denial of due process.

Central Bank v. CA
GR 45710, Oct. 3, 1985

The borrower's promise to pay is the consideration for the obligation of a lender-bank to furnish the amount being borrowed. When the borrower executes a real estate mortgage, he signifies his willingness to pay the loan. From such date, the obligation of the lender-bank to give the amount of loan, accrues, and from that date, the lender-bank's delay in furnishing the entire loan starts.

(4) Characteristics of the Right to Rescind or Resolve Under This Article

- (a) It exists only in *reciprocal* obligations. (Art. 1191, Civil Code). [Be it noted, however, that if the obligation is

reciprocal BUT *with a period*, neither party can demand performance or be considered in default before the expiration of the period. (*Abesamis v. Woodcraft Works, Ltd., L-18916, Nov. 18, 1969*).]

- (b) It can be demanded *only if the plaintiff is ready, willing, and able* to comply with his own obligation, and *the other is not*. [Otherwise, if neither is ready, neither can resolve. Moreover, the guilty party cannot rescind. He who comes to equity must come with clean hands. (*See Seva v. Berwia, 48 Phil. 581*).]
- (c) The right to rescind is *NOT absolute*. Thus:
 - 1) *Trivial causes or slight breaches* will not cause rescission. (*Song Fo v. Hawaiian-Phil. Co., 47 Phil. 821* — where the court refused rescission when there was a short delay in the payment of molasses.) [However, a substantial breach of an employee's obligations is sufficient cause to put an end to a contract of employment. (*Marcaida v. Phil. Educ. Co., L-9960, May 29, 1957* and *De la Cruz v. Legaspi, 51 O.G. 6212*).]

**Ang, et al. v. CA and Lee Chuy Realty Corp.
GR 80058, Feb. 13, 1989**

While it is true that in reciprocal obligations, such as the contract of purchase and sale in this case, the power to rescind is implied and any of the contracting parties may, upon non-fulfillment by the other party of his part of the obligation, resolve the contract, rescission will not be permitted for a slight or casual breach of the contract.

Rescission may be had only for such breaches that are so substantial and fundamental as to defeat the object of the parties in making the agreement.

**Filoil Marketing Corp. v. IAC, et al.
GR 67115, Jan. 20, 1989**

It is error to hold that a contract of sale is subject to rescission on the ground of non-compliance with

one of its conditions, presumably the payment of the purchase price, if the ground relied upon is merely assumed and not established. In fact, as revealed in the case at bar, it did not exist at the time of the filing of the complaint.

- 2) If there be a *just cause* for fixing the period within which the debtor can comply, the court will not decree rescission. (*Art. 1191, par. 3, Civil Code*). [But the court *cannot fix* the term in unlawful detainer cases where the lessee has not yet paid the rents for in the law of lease, the court has no such discretion under Art. 1659 of the Civil Code. (*See Mina v. Rodriguez, [C.A.] O.G. Supp., Aug. 30, 1941, p. 65*).]
 - 3) If the property is now in the hands of an innocent third party who has lawful possession of the same. (*Asiatic Commercial Corp. v. Ang, [C.A.] 40 O.G. [11th Supp.], p. 102*).
- (d) The right to rescind *needs* judicial approval in certain cases, and in others, *does not* need such approval.
- 1) *Judicial approval is needed* when there has already been *delivery* of the object (unless of course there is a voluntary returning). (*Guevara v. Pascual, 12 Phil. 311 and Escueta v. Pando, 76 Phil. 256*).
 - 2) *Judicial approval is NOT needed* when there has been no delivery yet (*See Magdalena Estate v. Myrick, 7 Phil. 344*) OR, in case there has been delivery, the contract stipulates that either party can rescind the same or take possession of the property upon non-fulfillment by the other party. (*Consing v. Jamandre, L-27674, May 12, 1975*).

Example:

I sold my car today to X for P800,000 with the stipulation that he gives me the payment at the Ateneo de Manila University tomorrow. If I have not yet delivered the car to him, and he does not come and pay tomorrow, I can consider the contract as automatically rescinded. (Art. 1593 of the Civil Code reads: "With

respect to *movable* property, the rescission of the *sale* shall of *right* take place in the interest of the vendor, if the vendee upon the expiration of the period fixed for the delivery of the thing should *not* have appeared to receive it, or having appeared, he should *not* have tendered the price at the same time, unless a longer period has been stipulated for payment.”) If upon the other hand, the car has *already been* delivered, I cannot take the law into my own hands and just get back the car without a judgment in my favor. (*See Ocejo Perez and Co. v. International Bank*, 37 Phil. 631). Nor am I, in the meantime, empowered to sell to another person the same car, without prejudice of course to the effects of Art. 1544 of the Civil Code. (*See Escueta v. Pando*, 76 Phil. 256).

- (e) The right to rescind is implied (presumed) to exist and, therefore, need not be expressly stipulated upon. (*Art. 1191, par. 1, Civil Code and Hodges v. Granada*, 59 Phil. 429).
- (f) The right to rescind may be waived, expressly or impliedly. (*Ramos v. Blas*, [C.A.] 51 O.G. 1920, Apr. 1955).

Angeles v. Calasanz, et al.
GR 42283, Mar. 18, 1985

Accepting delayed installment payments beyond the grace period amounts to a waiver of the right to rescind.

Quano v. Court of Appeals
GR 95900, Jul. 23, 1992

The act of the charterer in sub-chartering the vessel, inspite of a categorical prohibition may be a violation of the contract, but the owner’s right of recourse is against the original charterer, either for rescission or fulfillment, with the payment of damages in either case.

(5) Choice by the Injured Party

- (a) The injured party may choose between:
 - 1) fulfillment (specific performance) (*plus* damages);

- 2) or rescission (plus damages). (*Art. 1191, Civil Code*).
- (b) The right is alternative (*Art. 1191, Civil Code*) and an alternative prayer may be made in a court complaint unless either had been waived previously. (*TS, February 6, 1912*).
- (c) The right is *not conjunctive*, that is, the plaintiff cannot ask for BOTH remedies. (*Verceluz v. Edano, 44 Phil. 801 and Magdalena Estate v. Myrick, 71 Phil. 344*). Thus, if the plaintiff elects *fulfillment* of a reciprocal obligation, *rescission* thereof may not be declared at the same time. (*Bacordo v. Alcantara, L-20080, July 30, 1965*). However, in some cases, in the interest of justice *partial rescission* and *partial fulfillment* may be allowed. (*See Tan Guat v. Pamintuan, [C.A.] O.G. 2494*).

However, the rule is still that the rescission or resolution of a contract has the effect of abrogating it in all its parts, the creditor cannot demand rescission, and still insist on the performance of subordinate stipulations. Hence, a clause allowing for attorney's fees for the foreclosure of a mortgage cannot be availed of if the mortgage is itself rescinded. (*Po Paues v. Sequenza, 47 Phil. 404*).

- (d) The injured party who has elected *fulfillment* may, if fulfillment be impossible, still ask for rescission (provided that rescission is otherwise proper). (*Art. 1191, Civil Code*). The rule is *vice-versa*, provided the court has not yet given a final judgment.
- (e) If an action is brought for specific performance, the damages sought must be asked in the same action; otherwise, the damages are deemed waived. (*Daywalt v. Agustinian Corp., 39 Phil. 567*).

(6) Illustrative Cases

Ramirez v. Court of Appeals, et al.

98 Phil. 225

(Illustrating Effect of Loss in Connection with

Art. 1191)

FACTS: A and B were co-owners of a motor boat. In a written instrument, B sold her half-share in the boat to A for

P4,500 which was to be paid in three equal installments. It was agreed that in case of *first default*, A must pay interests; and that in case of *second default*, B gets back her half-share in the boat without the necessity of reimbursing A for whatever A has already paid. After *paying* two installments, A defaulted in the payment of the third installment. Subsequently, a fortuitous event destroyed the boat. B now instituted an action to recover what has *not* yet been paid (the third installment) plus 6% interest from default. A claims, however, that the loss of the boat by a fortuitous event has excused him from the obligation to pay the balance. *Issue*: Is he correct?

HELD: A must still pay. Under the contract and under the law, B, the seller-creditor, had the right to demand specific performance (payment) or rescission (getting back her share). She selected specific performance (for under the contract the *first default* entitled her to collect plus *interest*). The loss of the boat is immaterial, for the *generic* obligation to pay money is not extinguished or excused by the fortuitous loss of the boat.

Song Fo & Co. v. Hawaiian-Phil. Co.
47 Phil. 821
(Illustrating Effect of a Slight Breach)

FACTS: Song Fo and Co. ordered molasses from the Hawaiian-Phil. Co. When the time for payment came, Song Fo and Company was not yet ready to pay. It was only 20 days afterwards that the buyer offered to pay. The seller accepted the overdue account, and started delivering the molasses, but it later changed its mind and wrote a letter to the buyer, cancelling the contract. The buyer brought this action to enforce fulfillment. Decide.

HELD: The buyer wins the case for two reasons:

- 1) The breach of the contract — the delay of the payment — is only a slight breach, and is not substantial enough to warrant rescission;
- 2) Granting that there was a breach, still the seller *waived* this by accepting the payment of the overdue account. (See *Warner, Barnes and Co. v. Inza*, 4 Phil. 505).

(NOTE: In *Villanueva v. Yulo, et al.*, L-12985, Dec. 29, 1959, the Court held that a *non-substantial* breach of a contract cannot give rise to a rescission. Here, the breach was the failure to add P8,000 to the buying price, which amount was to be given as a bribe to the Japanese army officers — to prevent them from using the premises in question as their headquarters during the Japanese occupation. It turned out, however, that the Japanese did not really intend to use said premises — hence, the object of the contract was never defeated.)

Philippine Amusement Enterprises, Inc. v. Natividad
L-21876, Sept. 29, 1967

FACTS: Natividad leased a jukebox from the Philippine Amusement Enterprises Incorporated for a term of three years at an amount equal to 75% of the weekly gross receipts, but in no case to be less than P50 a week. Six months later, Natividad asked the lessor to take back the jukebox, because it could not operate properly (once in a while, the machine could not operate because the coins inserted therein would be stuck up). The lessor, however, refused to take back the machine. Eventually, the lessor sued Natividad for specific performance and damages on the theory that in the case of any coin-operated phonograph, the sticking-up of the coins was a *normal* occurrence. *Issue:* Will the lessor be allowed to recover?

HELD: Yes. The power to rescind must be exercised through the courts. This, Natividad did *not* do. Moreover, the breach of contract here is *not substantial* for the defect complained of did *not* render the jukebox unsuitable or unserviceable.

Asiatic Com. Corp. v. Ang
(C.A.) 40 O.G. (11th Suppl., p. 102)
(Illustrating Rights of Innocent Third Persons)

FACTS: Francisco Ang *bought* and *received* from the plaintiff 36 cartons of Gloco Tonic upon his promise to pay that very afternoon. Although he had not yet paid, he sold same to Mr. Tan, an innocent purchaser for value. The plaintiff now sues for the recovery of the cartons of Gloco Tonic from Mr. Tan.

HELD: Plaintiff cannot recover from Mr. Tan. His only right would be to proceed against Mr. Ang, for the law subordinates the right of rescission to the right of innocent third persons.

Guevara v. Pascual
12 Phil. 811
(Illustrating Necessity of Judicial Action When
There Has Been Delivery)

FACTS: *A* sold *B* a particular bar — the “New Coin Cafe.” *B* agreed to pay the price in installments in addition to paying a debt which *A* owed *C*. In other words, *B* was supposed to pay *C* *A*’s debt — as part of the purchase price. The contract contained two stipulations which provided:

- 1) That in case of non-fulfillment by either party, the contract would be rescinded;
- 2) And that in case the purchaser failed to comply with any of the stipulations of the contract, the bar was to be *returned* to the vendor without remunerating the buyer for any improvements she may have made.

B did not comply with the stipulations of the contract. As a matter of fact, she borrowed money from *C*. As a result, *C* brought an action against *B*. Judgment was rendered against *B*, and the sheriff attached the property (the bar) despite *A*’s protest. The property was then sold at public auction and the selling price was given to *C*. *A* then brought this action against *C*. It was proved that:

- 1) The sheriff *knew* of the contract between *A* and *B*, and was therefore in *bad faith* (for he should have notified the court).
- 2) *C* did not know of said contract between *A* and *B*, and was therefore in good faith.

Issue: May *A* recover from *C*? Why? If not, what is *A*’s remedy?

HELD: *A* cannot recover the bar from *C* because although it is true that the seller has the right to rescind in case the buyer should not fulfill his or her obligations, still rescission cannot be availed of because the property is now in the hands

of an innocent third person. A's remedy will be to get damages from B, and also from the sheriff, since both are in bad faith. It cannot be said that there was automatic rescission here (*for the property had already been delivered*). An affirmative judicial action to rescind or resolve should have been brought. (*See TS, Jan. 19, 1904 and Escueta v. Pando, 42 O.G. No. 11, p. 2750, which held that since the law says "The court shall decree the rescission claimed . . ." it follows that judicial intervention is essential.*)

(NOTE: Observe that if the property had not yet been delivered by A to B, there would have been no necessity of a judicial action of rescission.)

Magdalena Estate v. Myrick

71 Phil. 344

(Illustrating Effect of Making the Choice, Effect of Rescission and When Rescission May Be Allowed Even Without Judicial Approval)

FACTS: Mr. Myrick purchased on installment two lots from the Magdalena Estate for P8,000. After paying P2,500 he defaulted in the payment. Although there was no stipulation that in case of failure to continue paying the monthly installments, the money paid in previous installments would be forfeited in favor of the seller, and no stipulation about rescission, still the Estate informed Myrick that:

- 1) the contract would be considered already cancelled or rescinded;
- 2) the amount already paid would be forfeited.

After some time, Myrick instituted this suit to recover money he had previously paid, together with legal interest thereon.

The Estate contended that:

- 1) the contract did not provide for rescission; and
- 2) the rescission it had made was improper since the court had not approved the same; and
- 3) that therefore, since it chose specific performance, the money paid should not be returned.

HELD: The Magdalena Estate is completely wrong.

- 1) *Firstly*, although the contract did not provide for rescission, this right is expressly granted by the law for all reciprocal obligations.
- 2) *Secondly*, the remedies of the estate were therefore to *rescind* or to ask for *specific performance*. This right has been *already exercised* by it when it notified the buyer of its cancellation of the contract.
- 3) *Thirdly*, it cannot claim that the rescission was improper since it was the Estate itself that made the rescission and therefore it is now in estoppel and cannot repudiate its own actuations.
- 4) *Fourthly*, the contract having been rescinded, the parties must be restored to their original situation, insofar as practicable, and this can be done by returning the price paid already with interest from the date of the institution of the action, there being no stipulation about forfeiture. The remedies being alternative and not cumulative and the Estate, having elected to *cancel* the contract, it cannot now avail of specific performance.

(NOTE: The price would have been demandable had specific performance been asked. One cannot cancel the sale, and at the same time also get the price.)

(NOTE FURTHER, that in this case the Supreme Court allowed *rescission without* judicial authorization.)

Soledad T. Consing v. Jose T. Jamandre
L-27674, May 12, 1975
(Illustrating When Judicial Rescission
Is Unnecessary)

FACTS: In a contract between a sub-lessor (Jamandre) and a sub-lessee (Consing) it was agreed that if Consing would violate the contract, Jamandre would be authorized to take possession of the leased premises even without resorting to court action. Consing contends, however, that such stipulation is VOID because it amounts to a renunciation of one's day in court, and therefore null. Besides, "this might open the floodgates to violence which

our laws seek to suppress.” Jamandre alleges, however, that the stipulation does not provide for the use of force in taking possession of the property, and should therefore not be regarded as contrary to public policy. The stipulation reads: “that in case of the failure on the part of the sub-lessee to comply with any of the terms and conditions thereof, the sub-lessee hereby gives an authority to the sub-lessor or to any of his authorized representatives to take possession of the leased premises including all its improvements thereon without compensation to the sub-lessee and *without necessity of resorting to any court action*, in which case, the sub-lessee shall be duly advised in writing of her failure to comply with the terms and conditions of the contract by way of reminder before the takeover.”

ISSUE: Is this stipulation valid?

HELD: Yes, the stipulation is valid. It is in the nature of a resolutory condition, for upon the exercise by the sub-lessor of his right to take possession of the leased property, the contract is deemed terminated. This kind of contractual stipulation is legal, there being nothing in the law prohibiting such kind of agreement. As held in *Froilan v. Pan Oriental Shipping Co.*, L-11897, Oct. 31, 1964 — There is nothing in Art. 1191 of the Civil Code or in any other legal provision that prohibits the parties from entering into an agreement that violation of the terms would cause cancellation thereof, even without court intervention. In other words, it is not always necessary for the injured party to resort to the courts for rescission of the contract. As already held, judicial action is needed where (among other instances) there is absence of a special provision in the contract granting to a party the right of rescission (despite delivery of the subject matter).

Ramos v. Blas
(C.A.) 51 O.G. 1920, Apr. 1955
(Illustrating Implied Waiver of the
Right to Rescind)

FACTS: A sold his parcel of land to B. Later, B after paying the down payment, agreed to have the land be the *security* for the balance of the price. **Issue:** If B later cannot or does not pay, may A rescind the contract?

HELD: No more. What he can do is to *collect* the balance or foreclose the security, since his acceptance of the security can be considered equivalent to an implied waiver of the right to rescind.

Tan Guat v. Pamintuan
(C.A.) 37 O.G. 2494
(Illustrating Partial Rescission and Partial Performance)

FACTS: A bought lumber from B for the construction of his house. B delivered part of the lumber, which A immediately used. When B did not deliver the rest, A was forced to get lumber from other dealers. When B was ready to comply with the obligation of delivering the rest, A did not pay for such balance because he no longer needed them. B then sued A. A pleaded in defense that it was B who should be liable to him for the incomplete delivery. In his pleadings, A did not say, however, whether he wanted rescission or fulfillment. A evidently did not want rescission for then he would be obliged to return the lumber already used. A also evidently did not want fulfillment since he really did not need the rest of the lumber anymore.

HELD: There can be rescission regarding the *undelivered* lumber; and regarding the delivered lumber, there was already specific performance. Hence, A should pay what he still owes B for the delivered lumber, and in turn get damages from B for B's failure to complete the delivery of the lumber.

Abella v. Francisco
55 Phil. 447
(Rescission When Time Is of the Essence)

FACTS: Francisco sold his land to Abella to pay off certain obligations which fell due in the month of December, 1928. When the time for payment came, the buyer was not ready to pay, so the seller notarially rescinded the sale. Later when the buyer could pay, Francisco no longer wanted to sell. In other words, the seller desired rescission, the buyer desired specific performance.

HELD: Since time was of the essence here, the seller had the right to rescind upon the buyer's default. So, the seller should win.

(7) Damages for Breach of Lease Contract

How much damages may be recovered in case a lease contract is broken by, say, non-payment of rent when the period has not yet expired?

ANS.: It depends upon what remedy has been resorted to by the lessor (landlord).

- a) If he selects *specific performance*, he can demand the *accrued rent plus* the future rent for the *unexpired term*.

Example: 10 years contract. The first 2 years rent have not yet been paid. Lessor at the end of the 2 years demands specific performance. He gets the back rents for 2 years and the rents for the remaining 8 years, payable as they accrue, *plus damages*.

- b) If the lessor demands *rescission*, he gets only the back rents and ouster of the lessee, *plus* damages, but not (necessarily) the future rents or rentals for the unexpired term.

Rios v. Jacinto Palma, et al. **49 Phil. 7**

FACTS: A lease contract for 15 years at P400 a month was complied with for only 3 years, after which the lessee did not pay rent. The lessor asked the lessee to vacate the premises, if he could not afford to pay. The lessee then turned over the premises to the lessor. Now the lessor demands rent for the remaining 12 years.

HELD: Since the lessor decided to select *rescission*, he is now entitled to possession, but not to the future rents for the unexpired term. He cannot have both remedies of *rescission* and *specific performance*. Had the back rentals not been paid yet, he would have been entitled to them. In the instant case, he can collect only *special damages* those that resulted from the breach, not necessarily the unexpired rents. (*See Rubio de Larena v. Villanueva, 53 Phil. 932*).

**Spouses Mariano Z. Velarde & Avelina D. Velarde
v. CA, David A. Raymundo & George Raymundo
GR 108346, Jul. 11, 2001**

A substantial breach of a reciprocal obligation, like failure to pay the price in the manner prescribed by the contract, entitles the injured party to rescind the obligation.

Rescission abrogates the contract from its inception and requires a mutual restitution of benefits received.

(8) Damages in Case of Breach of Employment

**Sta. Cecilia Sawmills, Inc. v. CIR
L-19273 and L-19274, Feb. 29, 1964**

A ruling that would permit a dismissed laborer to earn backwages for all time or for a very long period of time is not only unjust to the employer but the same would foster indolence on the part of the laborers. The laborer is not supposed to be relying on a court judgment for his support, but should do everything a reasonable man would do; he should find employment as soon as employment has been lost, especially when the employment has to depend on a litigation. Indeed, he has to minimize his loss.

(9) Instance Where Article Is Inapplicable

**Suria v. IAC
GR 73893, Jan. 30, 1987**

FACTS: *HAC*, owner of the lot in dispute, entered into a deed of sale with mortgage with *GRJ*. *GRJ* paid only one installment, *i.e.*, the one due in Jul. 1975. All the others remained unsettled. Despite repeated demands, *GRJ* failed to comply. Thereafter, *HAC* sued *GRJ* for rescission. Meanwhile, *GRJ* offered to pay all outstanding balance under the Deed of Sale with mortgage. But *HAC* rejected the offer. Then, *GRJ* moved to dismiss on the ground that *HAC* is not entitled to subsidiary remedy of rescission because of the presence of the remedy of foreclosure. The trial court denied the motion.

The Court of Appeals sustained the trial court, saying the grant to the vendor-mortgagee (HAC) of the right to foreclose if the vendee-mortgagor (GRJ) fails to comply with the provisions of the mortgage merely recognizes the right of the vendors to foreclose and realize on the mortgage but does not preclude them from availing of their other remedies under the law such as rescission of contract and damages under Arts. 1191 and 1170 of the Civil Code in relation to Republic Act 6552.

The Supreme Court reversed the Court of Appeals and ordered the vendee-mortgagor (GRJ) to pay the balance of his indebtedness under the Deed of Sale with Mortgage with legal interests from the second installment due in 1975 until fully paid, failing which the vendor-mortgagee (HAC) may resort to foreclosure.

HELD: Art. 1191 on reciprocal obligations is not applicable under the facts of this case. Moreover, Art. 1383 of the Civil Code provides that the action for rescission is subsidiary. It cannot be instituted except when the party suffering damage has no other legal means to obtain reparation for the same.

The vendee-mortgagor's (GRJ's) breach of obligation is not with respect to the perfected contract of sale but in the obligations created by the mortgage contract. The remedy is not a principal action retaliatory in character, but becomes a subsidiary one which by law is available only in the absence of any other legal remedy. (*Art. 1384, Civil Code*). Foreclosure here is not only a remedy accorded by law but is a specific provision found in the contract between the parties. In the contract of purchase and sale, the parties stipulated that the payment of the price was guaranteed by the mortgage of the property sold. This agreement has the two-fold effect of: (1) acknowledging indisputably that the sale had been consummated, so much so that the vendee-mortgagor was disposing of it by mortgaging it to the vendor; and (2) of waiving the *pacto comisorio*, i.e., the resolution of the sale in the event of failure to pay the purchase price, such waiver being proved by the execution of the mortgage to guarantee the payment, and in accord therewith the vendor's adequate remedy, in case of non-payment, is the foreclosure of mortgage.

There is no cause for the resolution of the sale as prayed for by the vendor-mortgagee. His action should have been one

for the foreclosure of the mortgage, which is not the action in this case. Article 1191 is not applicable in this case, since the subject matter of the sale is real property. It does not come strictly within the provisions of Art. 1191 (Art. 1124, Spanish Civil Code), but is rather subjected to the stipulations agreed upon by the contracting parties and to the provisions of Art. 1592 (Art. 1504, Spanish Civil Code) of the Civil Code.

GRJ, the vendee-mortgagor, has offered to pay all past due accounts. Considering the lower purchasing value of the peso in terms of prices of real estate today, *HAC*, the vendor-mortgagee, is correct in stating that he has suffered losses. However, he is also to blame for trusting persons who could not or would not comply with their obligations on time. *HAC* could have foreclosed on the mortgage immediately when it fell due instead of waiting all these years while trying to enforce the wrong remedy. The '*pacto comisorio*' or '*ley comisorio*' is nothing more than a condition subsequent to the contract of purchase and sale. Considered carefully, it is the very condition subsequent that is always attached to all bilateral obligations according to Art. 1191 (Art. 1124, Spanish Civil Code); except that when applied to real property it is not within scope of said Art. 1191 (Art. 1124), and it is subordinate to the stipulations made by the contracting parties and to the provisions of Art. 1592. (Art. 1504, Spanish Civil Code).

(10) Extrajudicial Rescission

**Spouses Reynaldo Alcaraz & Esmeralda Alcaraz v.
Pedro M. Tangga-an, et al., GR 128568, Apr. 9, 2003**

FACTS: Petitioner-spouses rescinded the contract of lease without judicial approval. Due to the change in ownership of the land, petitioner-spouses decided to unilaterally cancel the contract because Virgilio supposedly became the new owner of the house after acquiring title to the lot. They alleged that there was no reason anymore to perform their obligations as lessees because the lesser had ceased to be the owner of the house.

HELD: There is nothing in the lease contract that allows the parties to extrajudicially rescind the same in case of violation of the terms thereof. Extrajudicial rescission of a contract is not possible without an express stipulation to that effect. (*Art. 1191*). What petitioner-spouses should have done was to file a

special civil action for interpleader for claimants to litigate their claims and to deposit rentals in court.

Art. 1192. In case both parties have committed a breach of the obligation, the liability of the first infractor shall be equitably tempered by the courts. If it cannot be determined which of the parties first violated the contract, the same shall be deemed extinguished, and each shall bear his own damages.

COMMENT:

Rule if Both Parties Have Committed a Breach

“The above rules are deemed just. The first one is *fair* to both parties because the second infractor also derived or thought he would derive some advantage by his own act or neglect. The second rule is likewise just, because it is presumed that both at about the same time tried to reap some benefit.” (*Report of the Code Commission, p. 130*).

Section 2

OBLIGATIONS WITH A PERIOD

Art. 1193. Obligations for whose fulfillment a day certain has been fixed, shall be demandable only when that day comes.

Obligations with a resolutory period take effect at once, but terminate upon arrival of the day certain.

A day certain is understood to be that which must necessarily come, although it may not be known when.

If the uncertainty consists in whether the day will come or not, the obligation is conditional and it shall be regulated by the rules of the preceding Section.

COMMENT:

(1) ‘Period’ Defined

A period is a certain length of time which determines the effectivity or the extinguishment of obligations.

(2) Manresa's Definition of a 'Period'

"A term or a period consists in a space of time which has an influence on obligations as a result of a judicial act, and either suspends their demandableness, or produces their extinguishment. . . Obligations with a period are, therefore, those whose consequences are subjected in one way or another to the expiration of said term." (*Manresa, Commentaries on the Civil Code, Vol. 8, p. 153*).

**Aparri v. Court of Appeals
L-30057, Jan. 31, 1984**

The term of office of the general manager of a corporation is not fixed by law but by the Board of Directors of the corporation.

(3) Period Distinguished from a Condition

(a) In their fulfillment —

A condition is an uncertain event; but a period is an event which must happen sooner or later, at a date known beforehand, or a time which cannot be determined.

(b) With reference to time —

A period always refers to the future, a condition may under the law refer even to the past.

(c) As to influence on the obligation —

A condition causes an obligation to arise or to cease, but a period merely fixes the time or the efficaciousness of an obligation. It is true that a period may have a suspensive or resolutive effect, but in the former, it cannot prevent the birth of the obligation in due time, and in the latter, it does not militate against its existence. (*8 Manresa 153, 154*).

(4) The Different Kinds of Terms or Periods

(a) — 1) *Definite* — the exact date or time is known and given.

- 2) *Indefinite* — something that will surely happen, but the date of happening is unknown (as in the case of death).
- (b) — 1) *Legal* — a period granted under the provisions of the law.
- 2) *Conventional or Voluntary* — period agreed upon or stipulated by the parties.
- 3) *Judicial* — the period or term fixed by the courts for the performance of an obligation or for its termination.
- (c) — 1) *Ex die* — a period with a suspensive effect. Here, the obligation begins only from a day certain, in other words, upon the arrival of the period.
- 2) *In diem* — a period or term with a resolutory effect. Up to a time certain, the obligation remains valid, but upon the arrival of said period, the obligation terminates. (*See 8 Manresa, pp. 160, 169*).

(5) Example of an Obligation with a Period ‘Ex Die’

“I will support you, beginning the first day of next year.” Here, the obligation only becomes effective on the day stipulated.

(6) Example of an Obligation with a Period ‘In Diem’

“I will support you until Jan. 1 of next year.” Here, the obligation is immediately demandable and will end only on Jan. 1 of the next year.

**New Frontier Mines, Inc. v. National Labor
Relations Commission and Crisanto Briones
GR 51578, May 29, 1984**

A managerial employee who goes on leave without permission and while being audited (cash shortage having been discovered) may be dismissed or terminated for lack of confidence.

(7) Queries

- (a) “I will support you from the time *X* marries.” Is this an obligation with a term or a conditional obligation?

ANS.: This is a conditional obligation because we cannot be sure whether or not *X* will marry. In other words, this is an obligation with a suspensive condition, not an obligation with a suspensive term.

- (b) “I will begin supporting you if your father dies.” Is this a conditional obligation or an obligation with a term?

ANS.: This is an obligation with a term *ex die* — a term with a suspensive effect. Even if the word “if” was used, still there is no doubt that “your father” will die, sooner or later.

- (c) “I will begin supporting you from the time your father *dies* of *malaria*.” Is this an obligation with a term?

ANS.: This is an obligation with a suspensive condition. It is true that “your father” will die sooner or later, BUT we are not sure whether or not he will die of malaria. Hence, we have here a condition instead of a term.

- (d) “I will pay you my debt when my means permit me to do so.” Is this an obligation with a condition or an obligation with a term?

ANS.: This is considered by the law as an obligation with a term. “When the debtor binds himself to pay when his means permit him to do so, the obligation shall be deemed to be one with a period, subject to the provisions of Art. 1197.” (*Art. 1180, Civil Code*).

NOTE: In *Gaite v. Fonacier, et al.*, L-11827, Jul. 31, 1961, the balance of price in a sale of iron ore was stipulated to be paid out of the first proceeds from a transshipment of the ore. The court held that said transshipment is a *suspensive* term (not a suspensive condition) because whether or not there could be a transshipment, the balance still owing had to be paid. The stipulation on transshipment was intended merely to fix the future date of the payment.

(8) ‘A Day Certain’ Defined

“A *day certain* is understood to be that which must necessarily come, although it may not be known when.” (*Par. 3, Art. 1193, Civil Code*).

[NOTE:

- (a) When we know that something will happen but we are uncertain as to the time it will happen, this is a term.
- (b) When we are not even sure if something will happen as a fact or not, this is a condition.]

(9) Some Cases

**De Cortes v. Venturanza
79 SCRA 709**

If it is alleged that a certain written contract with a definite period is really conditional, but the condition is *not* indicated thereon (such as the condition that a buyer will pay only if he is able to collect in turn the purchase price of his own two *haciendas*, sold to another entity), the contract will not be regarded as conditional but one that is with a definite term.

**Lirag Textile Mills, Inc. and Felix K. Lirag
v. Court of Appeals and Cristan Alcantara
L-30736, Jul. 11, 1975**

FACTS: Alcantara was persuaded by Felix Lirag of the Lirag Textile Mills to give up a permanent job and to join Lirag in the latter’s business until such period as when Alcantara would voluntarily resign or until Alcantara is removed for a valid cause. Sometime later, Alcantara was removed on account of financial reverses on the part of the Company (a ground which proved, however, to be *false*). *Issue:* In an action by Alcantara for damages, would the provisions of RA 1052 as amended (the Termination Pay Law when there is no time fixed for employment) apply such that all that Alcantara will receive is a small sum based on the number of years he has been employed by the Company?

HELD: RA 1052 as amended, will *not apply*, because in the present case there is an *express agreement* as to the period of Alcantara's employment, that period to start from Alcantara's employment up to the time Alcantara may voluntarily resign, or when the employer removes Alcantara for a valid cause. Thus, the employment has a period subject only to the resolutive condition of resignation or removal for cause. RA 1052 as amended by RA 1787, does not apply. The employer, having terminated Alcantara's employment without a valid cause, committed a breach of contract making it liable for damages. (*Art. 1170, Civil Code*).

Smith, Bell & Co. v. Sotelo Matti
44 Phil. 874

FACTS: A ordered goods from B. The goods were supposed to be paid for *when they arrived from the U.S.* It was proved that for the goods to be able to leave the U.S., the U.S. Government had to give a certificate of priority and permission; otherwise, the goods would have to remain in the U.S. **Issue:** Is the arrival of the goods in Manila from the U.S. a term or a condition?

HELD: The arrival of the goods is uncertain, owing to the different requirements that had to be complied with first. Hence, the arrival of said goods is a condition, not a term.

Compania General de Tabacos v. Anoz
7 Phil. 455

FACTS: A was indebted to B. The debt was supposed to be paid in installments. There was no provision in the contract by which upon failure of one installment of the debt, the whole debt should thereupon become at once payable. A was unable to pay one installment on time. B brought an action not only to recover said installment but the entire debt. **Issue:** How much can B recover?

HELD: B can recover only the installment due. The balance is not yet demandable, and will become so only at the time stipulated by the parties. This is because there was no ACCELERATION CLAUSE.

Berg v. Magdalena Estate, Inc.
92 Phil. 110

The clause “until the defendant shall have obtained a loan from the National City Bank of New York, or after it has obtained funds from other sources” should be considered a condition (and not a term), for the obtaining of funds may or may not happen. (As a matter of fact, here the loan never materialized.)

Santos v. Court of Appeals
L-60210, Mar. 27, 1984

A lease on a “month to month basis” is one with a *definite term*, and is, therefore, not governed by PD 20 or Batas Pambansa Bilang 25 (following the *RANTAEL* case). (See *Rantael v. Llave*, 97 SCRA 453).

J. Ameurfina Melencio-Herrera:
(concurring and dissenting)

The mere fact that payment of rent is made every month does not follow that the lease is really on a “month to month basis” (otherwise, there will hardly be any occasion where PD 29 or BP 25 can be applied). For the two laws to apply, there must really be an agreement that the lease is from month to month. Where there is no “monthly basis,” PD 20 and BP 25 can apply, even if the rent is paid monthly.

Balucanag v. Judge Francisco
GR 33422, May 30, 1983

If the rent agreed upon is payable on a monthly basis, the duration of the lease is deemed from month to month, and the lessor is allowed to terminate the lease after each month, provided there is due notice. After such notice, the lessee’s right to continue in possession ceases, and an action of unlawful detainer may be brought against him.

Ace-Agro Development Corp. v. CA
GR 119729, Jan. 21, 1997
78 SCAD 146

ISSUE: Because the suspension of work under a contract has been brought about by *force majeure*, is the period during

which work has been suspended justify an extension of the term of the contract?

HELD: No. The fact that the contract is subject to a resolutory period, which relieves the parties of their respective obligations, does not stop the running of the period of their contract.

(10) Requisites for a Valid Period or Term

- (a) It must refer to the future.
- (b) It must be *certain* (sure to come) but can be extended. (If eliminated subsequently by mutual agreement, the obligation becomes pure and immediately demandable). (*Estate of Mota v. Serra*, 47 Phil. 464).
- (c) It must be physical and legally possible, otherwise the obligation is *void*. (*Example*: “I’ll give you my house one year after *your death*.” The obligation here is void.)

(11) Query

- (a) If an obligation is demandable “on or about Dec. 5, 2005,” when is it really demandable?

ANS: A few days before or after Dec. 5, 2005, and not a date far away nor one fixed by the debtor. (*See Sy v. De Leon*, [C.A.] GR 288-R, Sept. 25, 1974).

- (b) An obligation stated “A will give B a car the moment X becomes 30 years old.” Now, X is only 28. Suppose X dies at the age of 29, should A still give the donation?

ANS.: Yes, it would seem that the parties really intended a term, and not a condition, unless facts should exist which show that the parties intended a condition. (*See Art. 606 of the Civil Code by analogy*).

(12) When Period of Prescription Begins

The *period of prescription* commences from the time the term in the obligation arrives, for it is only from that date that it is due and demandable. (*See Ullmann v. Hernaez*, 30 Phil. 69).

(13) Extension of Period

Evidence of *extension* of period, if any be given, must be shown by debtor. (*See Phil. Engineering Co. v. Green*, 48 Phil. 466).

(14) The Moratorium Laws of the Philippines

Shortly after liberation, we had our so-called Moratorium Laws. (*Ex. Orders Nos. 25, 32 [1945] and RA 342 [1948].*) The purpose of a moratorium is to obtain a *postponement* of the period within which to pay off obligations. It is a suspension of payment, an act of grace. In the case of *Rutter v. Esteban*, 93 Phil. 68, the Moratorium Laws were declared (in 1953) as *unconstitutional* because:

- (a) the *period* stated in the law is indefinite;
- (b) and the continuation of the moratorium will be unreasonable and oppressive to creditors, inasmuch as, considering the period that has elapsed since liberation, the debtors may be said to have already rehabilitated themselves. (*See also Llanes v. Insular Life Assurance Co.*, GR L-64656, Apr. 14, 1954).

[*NOTE*: In general, the Moratorium Laws may be applicable also to obligations contracted before the war. (*Rio y Compania v. Datu Jolkipli*, L-12301, Apr. 13, 1959).]

Art. 1194. In case of loss, deterioration or improvement of the thing before the arrival of the day certain, the rules in Article 1189 shall be observed.

COMMENT:**Rules in Case of LOSS, Deterioration, or Improvement**

- (a) Note the cross-reference to Art. 1189 of the Civil Code.
- (b) *Example*: If A is supposed to deliver to B a particular car on Mar. 1, 2005 but the car is destroyed by a fortuitous event on Dec. 15, 2004, the obligation is extinguished.

Art. 1195. Anything paid or delivered before the arrival of the period, the obligor being unaware of the period or believing that the obligation has become due and demandable, may be recovered, with the fruits and interests.

COMMENT:

(1) Payment or Delivery Made Before the Arrival of the Period

- (a) A was supposed to pay *B* P1,000,000 on Dec. 31, 2005. But believing that the obligation was due and demandable already on Dec. 31, 2004, A paid *B* the P1,000,000 on said date. How much may A recover from *B*, say on Jun. 30, 2005?

ANS.: A may recover from *B* on Jun. 30, 2005, the amount of P1,000,000 which had been prematurely paid plus of course interest at the legal rate from Jan. 1, 2005, to Jun. 30, 2005, 6% of P1,000,000 = P60,000 (interest for one year). $P60,000 \div 2 = P30,000$ (interest for the half-year period from Jan. 1, 2005, to June 30, 2005). So A may recover a total of P1,000,000 from *B*. Of course, when Dec. 31, 2005 finally arrives, A is supposed to give *B* the P1,000,000. Here A is allowed to recover what had been in good faith prematurely paid, plus interest of course.

- (b) Suppose in the preceding problem, A had paid prematurely knowing fully well of the existence of the term, how much can A recover?

ANS.: A can recover nothing. The reason is the law does not give him such a right. To be able to recover, A:

- 1) must have been unaware of the period; or
- 2) must have believed that the obligation has become due and demandable.

Since A did not have either of these two conditions, he cannot recover. The reason for these implied provisions of the law is, after all, A is supposed to pay *B*, sooner or later so why let him recover since, anyway, it was A's fault that premature payment had been made. Of course, *under either of the conditions listed hereinabove*, even if A is bound to

pay *B* sooner or later, still it is unjust to deprive *A* in the meantime of the money as well as its use (interest).

- (c) On Mar. 1, *A* sold *B* a particular automobile. It was agreed that payment and delivery were to be made on Mar. 31. But on Mar. 15, *A* delivered the car and *B* paid for said car. Pending the arrival of Mar. 31, should *B* return the car plus damages and should *A* return the price plus interest?

ANS.: There should be no returning for two reasons:

- 1) It is true that Mar. 31 was the date set for payment of the price and delivery of the car, but the subsequent actions of the parties concerned show that both implicitly agreed to the changing of the date specified — from Mar. 31 to Mar. 15.
- 2) Even if there had been no change in the date agreed upon, still it must be remembered that the problem here is one where we are dealing not *with two unilateral obligations*. And we already know that in reciprocal obligations, pending the fulfillment of the condition (and, therefore, also pending the *termination of the period*) the interests and fruits are deemed to *compensate* each other, when there has been premature performance on both sides. (*Art. 1187 of the Civil Code*). (*See 8 Manresa 166*).

(2) Period Within Which Recovery May Be Made

- (a) Within what period must recovery be made if the debtor *did not know* that payment was *not yet due*?

ANS.: Before the debt matures (regarding what was paid). *Even after maturity* (regarding interest) for after all the creditor was in BAD FAITH. (*But* the right prescribes 5 years after premature payment.) (*See Art. 1149, Civil Code*).

- (b) Within what period, *if any*, must recovery be made if the debtor *knew* that payment was *not yet due*?

ANS.: No recovery can be had of what has been paid, much less can there be recovery of interest. This is true whether the creditor is in good or bad faith, since

the important thing is the *knowledge* by the debtor of the PREMATURENESS (Implied Waiver).

(3) Presumption that Debtor Knew of Prematureness

The law presumes that the debtor knew of the prematureness. This may, however, be rebutted by him. (*8 Manresa 164*).

(4) Different Meanings of Phrases

Note that the phrases “*within 8 years*” and “*within the 8th year*” have different meanings.

Art. 1196. Whenever in an obligation a period is designated, it is presumed to have been established for the benefit of both the creditor and the debtor, unless from the tenor of the same or other circumstances it should appear that the period has been established in favor of one or of the other.

COMMENT:

(1) For Whose Benefit the Term Has Been Established

General Rule

Term is for the benefit of debtor or creditor. (*Meaning: The debtor cannot pay prematurely and the creditor cannot demand prematurely*).

[*NOTE: This Article applies only where the parties to a contract themselves have fixed a period, and not to a case where the parties have authorized the Court to fix a reasonable term. (Orit v. Balrodgan Co., Ltd., L-12277, Dec. 29, 1959).*]

(2) Exceptions (if there be such *intent*)

- (a) Term is for the *benefit of debtor alone*. [*Meaning: He is required to pay only at the end, but he may pay even before. Example: D will pay C “within 6 years.” Here D can pay even after one week from the time the obligation was contracted. (See Sia v. Court of Appeals, 48 O.G. 5259). D may also resist premature demand for compliance. (See Samson v. Andal de Aguila, L-5932, Feb. 25, 1954).*]

- (b) Term is for the benefit of the creditor alone. (*Meaning: Creditor can demand at any time even before the term expires, and he cannot be compelled to accept payment from the debtor prior to the stipulated period.*)

Example: D promised to pay on Dec. 1, 2005, with the creditor given the right to demand performance even before said date.)

(3) Circumstances Which Indicate For Whom the Benefit of the Term Is

- (a) *For the benefit of both*
- 1) When there is *interest* stipulated (Here the *creditor* is interested in the term because of the interests that would be earned; the debtor is interested because he is given enough time to pay). (*See Sarmiento v. Vilaseñor, 43 Phil. 880.*)
 - 2) When the creditor is interested in keeping his money safely invested (thus making the debtor a sort of depository), or when the creditor wants to protect himself from the dangers of currency depreciation.

Nicolas, et al. v. Matias, et al. 89 Phil. 126

FACTS: During the Japanese occupation (Jun. 29, 1944), *D* borrowed P30,000 from *C* in Japanese currency at 6% interest *per annum*. Maturity — on any day “within the 6th year” (*not within 6 years, but during the 6th year*); in other words, between *Jun. 30, 1949 and Jun. 29, 1950*. On Jul. 15, 1944, *D* wanted to pay the whole amount, and even offered to pay interest for 5 years. (Evidently, *D* was aware of the decreasing purchasing value of the peso at that time). **Issue:** Can *C* be compelled to accept?

HELD: No, *C* cannot be compelled to accept. Here, the benefit of the term is for both *D* and *C* — for *D*, because he could use the money for at least 5 years; and *C*, because *C* had wisely calculated that after 5 years, the chances were that the Japanese as well as the Japanese currency would no longer be in

the Philippines. Moreover, for *C* to accept 5 years' *interest* would be for him to violate the Usury Law, which allows payment of advance interest for only *one year*.

(b) *For the benefit of the debtor*

- 1) When the loan is *without interest*, this is *generally* only for the benefit of the debtor.

[NOTE: This rule, however, is NOT absolute, for even if the creditor receives *no* interest, still he may have entered into the contract to protect himself against the sudden decline in the purchasing power of the currency. (*Aguilar v. Miranda*, L-16510, Nov. 29, 1961).]

- 2) When payment is to be made "*within*" a certain period from date of contract. (*See Samson v. Aguila*, *supra*).

(c) *For the benefit of the creditor*

[Usually, this only exists if there is a stipulation to this effect, as when the contract provides that *no payment should be made* till after a certain given period. (*See Ochoa v. Lopez*, [C.A.] 50 O.G. 5871, Dec. 1954). Acceptance of partial payment even before the expiration of the period means a *waiver* on the part of the creditor of his right to refuse payment before the end of said period. (*Lopez v. Ochoa*, L-7955, May 30, 1958).]

(4) Some Decided Cases

Sarmiento v. Villaseñor **43 Phil. 880**

FACTS: A borrowed money from B, and pledged a medal with diamonds as security. It was agreed that A was to pay the money loaned with interest at the end of one year. **Issue:** Before the expiration of the one-year period, is A allowed to pay his debt and recover the medal pledged?

HELD: No, unless B consents, for the one-year period was established for the benefit of both.

Pastor v. Gaspar
2 Phil. 592

When a contract provides for stipulations in favor of the debtor — *which the debtor has anyway even if the contract does not mention them* — the term is for the debtor's benefit.

Illusorio and Vida v. Busuego
L-822, 1949

FACTS: A borrowed P35,000 from B with interest of 8% *per annum*. As security, A mortgaged several parcels of land in favor of B. The contract provided that the debt would be payable within a period of 3 years, BUT the mortgagor would not be allowed to pay the debt before said time UNLESS the mortgagee B should consent. The contract was entered into in 1943. Later, A sold the lands to C. C assumed A's obligation toward B. In 1944, C was paying B the whole debt, with 3 years interest, but B refused. Thereupon, C deposited the money in court and both A and C filed an action to compel B to accept the payment. *Issue:* May C pay B the whole debt even before the expiration of three years and without the consent of B, provided that C would pay the interest for the whole three years?

HELD: No. Of course, the obligation could be paid within three years, but the contract *required B's consent* if the payment was to be made before the end of three years. Since B did not consent, it is clear that C cannot yet pay. Both conditions must be given effect. (*Dissenting:* Yes. It is true that B's consent is required if premature payment is to be made but evidently, the only purpose of this was to make sure that the interest for 3 years would be paid; otherwise, there would be the danger that the debtor would pay prematurely and give a lesser amount of interest. Since this fear has been eliminated by the offer to pay interest for the whole three years, there is *no reason* why B should not now accept. In this way, both conditions of the contract are being given effect. The majority disregards the first condition, and gives effect only to the second.)

Ochoa v. Lopez
(C.A.) 50 O.G. 5871, Dec. 1954

FACTS: D borrowed from C a sum of money secured by a mortgage. The contract stipulated that the debtor D *would not*

be allowed to pay till after the end of two years from the date the contract was perfected. Before the end of the two years, however, D offered to pay partially, and C accepted the partial payment. Issue: What is the effect of C's acceptance of the premature partial payment?

HELD: While at the beginning it was clear that the creditor had the benefit of the term, his acceptance of the premature partial payment implies his renunciation of the benefit of the term. He had the right to refuse, but he did not.

**Nepomuceno v. Narciso, et al.
84 Phil. 542**

FACTS: A stipulation in a contract of mortgage provided that the mortgagor should not pay off the mortgage while the war (World War II) was going on. *Issue:* Is the stipulation valid?

HELD: Yes, because it is neither contrary to law nor to morals, public order, and public policy.

(5) When Prescriptive Period Begins

Under the New Civil Code, an action upon a written contract (of loan, for example) must be brought *within 10 years* from the time the *right of action accrues*. (Art. 1144). In obligations with the benefit of the term given to both debtor and creditor, the right of action accrues from the end of the stipulated period, because it is only from that time that the obligation really becomes enforceable. (See *Sarmiento v. Villaseñor*, 43 Phil. 880).

Art. 1197. If the obligation does not fix a period, but from its nature and the circumstances it can be inferred that a period was intended, the courts may fix the duration thereof.

The courts shall also fix the duration of the period when it depends upon the will of the debtor.

In every case the courts shall determine such period as may under the circumstances have been probably contemplated by the parties. Once fixed by the courts, the period cannot be changed by them.

COMMENT:**(1) When the Court May Fix a Period**

- (a) When the duration depends upon the *will of the debtor*.

Examples:

- 1) “when my means permit me to do so” (*Art. 1180, Civil Code*)
- 2) “I’ll pay you little by little” (*Seone v. Franco, 24 Phil. 309*)
- 3) “as soon as possible” (*Gonzales v. Jose, 38 O.G. 1751; 66 Phil. 369*)
- 4) “as soon as I have money” (*Patente v. Omega, GR L-4433, May 29, 1953*)
- 5) “in partial payments” (*Levy Hermanos v. Paterno, 18 Phil. 353*)
- 6) When the debtor is “in a position to discharge his obligation.” (*See Luding Hahn v. Lazatin, et al., L-11346, 11549, Jun. 30, 1959*).

- (b) When although the obligation does not fix a period, it can be *inferred* that a period was intended.

Examples:

- 1) A contract to construct a house where the period was not stated. (*See Concepcion v. People, 74 Phil. 163*).
- 2) A donation where land was given provided certain construction was to be made on it. Here the time within which construction is to be made should be fixed by the courts. (*Barretto v. City of Manila, 7 Phil. 416*).
- 3) An obligation with an *indefinite* period, such as when the time for the payment of a subscription of shares of stocks has *not* been fixed. As a matter of fact in a case like this, the obligation must generally be *immediately* fulfilled, giving the debtor only such time as might *reasonably* be necessary for its actual fulfillment. (*Schenker v. Gemperle, L-16499, Aug. 31, 1962*).

- 4) In a lease contract, the court must fix the duration of the lease when a stipulation thereof reads — “The owners of the land undertake to maintain the Lawn Tennis Club *as tenant as long as the* latter shall see fit.” (Here the court said that Art. 1197 applies because there was a *conventional period* though it was indefinite, and not Art. 1687 which applies only when no period was agreed upon, in which case the law fixes the *legal period* stated in Art. 1687) (*Eleizgui v. Lawn Tennis Club*, 2 *Phil.* 309); or when the contract states “as long as the tenant pays the stipulated rent.” (*Yu Chin Piao v. Lim Tuaco*, 33 *Phil.* 92).
- 5) In a sale on credit, when the parties *forgot* to state in the *invoice* the period for payment. (*Cosmic Lumber Co., Inc. v. Manois*, L-12692, Jan. 30, 1960).

(NOTE: In *Deudor, et al. v. J.M. Tuason and Co., et al.*, L-13768, May 30, 1961, the Supreme Court ruled that when by virtue of Art. 1197, the court fixes the term, it does *not* thereby amend or modify the obligation concerned because said Article is *part and parcel* of all obligations contemplated therein. Hence, whenever the period is fixed, the court merely enforces or carries out an *implied stipulation* in the contract.)

**Gregorio Araneta, Inc. v. Phil. Sugar Estates
Development Co.
L-22558, May 31, 1967**

FACTS: In a contract of sale, it was agreed that the buyer would build on a parcel of land the Santo Domingo Church and convent, while the seller would construct street bordering the lot. The seller failed to finish the construction of the street on *one* side because some squatters thereon *refused to vacate*. The church was eventually finished. In 1958, the buyer brought the instant case against the seller to compel him to comply with his obligation, and to pay damages. The defense was that the obligation, to construct the street, was with a period, hence, the complaint was *premature*, as the buyer must first ask the court to fix the period. Incidentally, the presence of the squatters was known to the parties at the time the contract was

entered into. Moreover, there was a pending case against said squatters. *Issue*: Does the Court still have to fix the period?

HELD: Yes, in view of the knowledge of both parties of the presence of the squatters. Because of this knowledge, the parties must have intended to defer performance until the squatters shall have been duly evicted. The term fixed by the court was clearly just “until all the squatters are finally evicted.”

(2) When the Court May Not Fix the Term

- (a) When *no term was specified* by the parties because *no term was even intended*, in which case the obligation is really a *pure one*, and demandable at once, unless of course absurd consequences would arise. (*Art. 1179, par. 1 of the Civil Code by implications; TS, Oct. 20, 1892*).
- (b) When the obligation or note is “payable on demand.” (*People’s Bank v. Odom, 64 Phil. 126*).
- (c) When a repairer of typewriters who has been given a typewriter to repair but without a period within which to do the work, returns the typewriter without performing any work thereon, he has lost whatever right he originally had to have the period fixed under Art. 1197. (*Chaves v. Gonzales, L-27454, Apr. 30, 1970*). Here, the owner of the machine had it repaired by someone else. The Court ruled that the original repairman can be required to pay the person who actually made the needed repairs. The Court applied Art. 1167. (*Ibid.*)
- (d) When specific periods are provided for in the law, as in an *employment contract* where if no period was agreed upon, the time of employment depends upon the *time for payment of salary*.

Example:

Barretto v. Santa Marina 26 Phil. 440

FACTS: A was employed by B as manager of a cigar and cigarette factory, the “La Insular.” B obligated himself

to use *A*'s services so long as *A* did not show discouragement in his work. Later *A* was discharged. *A* complained that *B* should have first brought an action to fix the duration of the period here, and since *B* did not, *A* now desires to obtain damages.

HELD: This is not an obligation with an intention to grant the debtor a term, because this case is governed by the specific provisions regarding agency.

[**NOTE:** The employment of a person who has worked for a very long time, say from 1931 to the time of his separation in 1962, *cannot* be deemed to be one *without* a definite period; in other words, his employment should be considered as one with a period, and therefore he cannot be dismissed without just cause — under the Termination Pay Law. (*See Luzon Stevedoring Corporation v. Court of Industrial Relations*, L-34300, Nov. 22, 1974).]

[**NOTE:** Employees, even with fixed terms, can ordinarily be dismissed for acts inimical to the interests of the employer. For instance, the following acts of *security guards* are, among others, just causes for dismissal: challenging superior officers, insubordination, sleeping on the posts, dereliction of duty. (*Luzon Stevedoring Corp. v. CIR*, L-17411, 18681, 18683, Dec. 31, 1965)].

Nicanor M. Baltazar v. San Miguel Brewery
L-23076, Feb. 27, 1969

FACTS: Baltazar was a salesman in charge of the Dagupan warehouse of the San Miguel Brewery. His employment was *without* a definite period. Because of 48 days of absence without permission or proper reason, Baltazar was dismissed by the Company for what was admittedly a just cause. **Issue:** Now then, is he entitled to the one-month (*mesada*) separation pay provided for in RA 1052 as amended?

HELD: No, because his dismissal was for a just cause. It is well-settled in this jurisdiction that if the dismissal is for a just cause, a person *without* a definite term of employment is *not* entitled to one month notice or in lieu thereof

to one month salary. If an employee hired for a definite period can be dismissed for a just cause *without* the need of paying him a month's salary, an employee hired without a definite tenure should *not* be allowed to enjoy better rights.

- (e) When what appears to be a term is really a condition (such as when a debt is payable only after the debtor's estate's other debts have been paid, for this does not depend upon the exclusive will of the debtor). (*See Martin v. Boyero, 55 Phil. 760*).
- (f) When the period within which to ask the Court to have the period fixed has itself already prescribed. (*Calero v. Carrion, et al., L-13246, Mar. 30, 1960*).

(3) Applicability of the Article to the Obligations Contemplated Therein

Art. 1197 should be considered as part and parcel (or automatically incorporated) in all obligations which are contemplated therein. Thus, for example, if the obligation intends to grant a term but the term has not been fixed, the Court will be authorized to do so. Please note that if the Court, pursuant to the Article, actually fixes the term, the Court does not amend or modify the obligation. The Court merely enforces or carries out an implied stipulation in the contract. (*Deudor v. J.M. Tuason and Co., Inc., L-13768, May 30, 1961*).

(4) The Action to Bring Under This Article

The only action which the creditor can bring upon an obligation that does not fix a term, but where a term was indeed intended, is to *ask the court to fix the period* within which the debtor must pay for the simple reason that the fulfillment of the obligation itself cannot be demanded until after the court has fixed the period for its compliance. (*Vda. de Ungson v. Lopez, [C.A.] GR L-10180-R, Mar. 10, 1954, 50 O.G. 4298*). The Court may fix the period, even if this has *not* been specifically asked, so long as the prayer, for example, asks for "such other and further relief as to the court may appear just and equitable." (*Paul Schenker v. William F. Gemperle, L-16499, Aug. 31, 1962*).

And ordinarily specific performance cannot be demanded at the *same time* that the court is asked to fix the period (*Concepcion v. People*, 74 Phil. 62, decided, Aug. 1943), such action for specific performance being *premature*. (*Eleizegui v. Lawn Tennis Club*, 2 Phil. 309). In a case, however, the Supreme Court has ruled that in exceptional instances, as when a prior and separate action would be a mere formality and serve no other purpose but delay, there is no *necessity* of such prior action. (*Tiglaio, et al. v. MRR Co.*, *infra*.)

Illustrations:

Tiglaio, et al. v. Manila Railroad Co.
98 Phil. 181

FACTS: The Manila Railroad Co. paid its employees a part of the latter's salary differentials and promised to pay the balance after "funds for the purpose would be available." This was an action by the employees to recover said balance. One point raised by the company was that a separate action was first necessary to fix the duration of the term within which it would be required to pay.

HELD: Since the time for payment here really depended on the judgment of the Board of Directors of the Company, this may be considered as an obligation with a term whose duration has been left to the will of the debtor, so that pursuant to the law, the duration of the term should be fixed by the court. Although the general rule is to first bring a separate action for the express purpose, *still* as in this case, *if this point has been raised and discussed in the pleadings* the court has power *already* to fix the term, without the necessity of instituting a separate action precisely for that purpose, such prior and separate action being a mere formality in this case, and serving no other purpose but delay. The term of *one year* set by the lower court was thus affirmed by the Supreme Court.

(**NOTE:** It would seem here that the bringing of the case to *compel* payment is *premature*, since the right to demand compliance accrues only at the *termination* of the one-year period fixed. It is as if I am bound to pay X P1,000 at the *end* of three years. Obviously, the case can be dismissed for the cause has not yet accrued.)

[NOTE: In the case of *Pages v. Basilan Lumber Co.* (L-10679, Nov. 29, 1958), the Supreme Court held that when a would-be purchaser has *not* been given a definite time limit as to when he should make the purchase, he is *not* in default even if the would-be seller makes a demand. What the latter must do first should be to ask that the court fix the term. (See *Server v. Eisenberg & Co.*, L-10741, Mar. 29, 1958).]

Epifanio Alano, et al. v. Claro Cortes, et al.
L-15276, Nov. 28, 1960

FACTS: The litigants in a certain civil case entered into a judicial compromise whereby Alano, who owed Cortes a sum of money, would pay Cortes P131,000, and Cortes would in turn convey to him a certain parcel of land. The Court ordered the parties to comply with their respective obligations. Because Alano failed to pay, Cortes filed a motion in the same case asking the court to fix a date on which the obligation of Alano should be paid. The Court then fixed a period of 30 days within which the plaintiff should pay. The Court also wrote in its order a forfeiture clause, by virtue of which the right of Alano over the property would be forfeited in case of failure to pay within said 30 days. *Issue:* Is the judicial order valid?

HELD: Yes, because it was a step necessary to give force and effect to its decision. The judgment being based on a compromise, it was immediately executory, and the court, in fixing the period, merely implemented its decision. It is preposterous to presume that no period was intended by the parties, and that they intended to leave the performance of their undertaking to the whim of either party, thereby frustrating the very purpose of the agreement. The forfeiture clause is also justified under the Rules of Court which says that when after judgment has become final, facts and circumstances transpire which render the execution of a judgment impossible or unjust, the interested party may ask the Court to *modify or alter the judgment to harmonize the same with justice and with the facts.*

(5) Query: Within What Period Must the Action to Fix the Period Be Brought?

ANS.: Within the proper prescriptive period for *specific performance* if a period had been originally fixed, but to be counted

from the perfection of the contract. This is because the right exists by operation of law from the moment of such agreement. Extrajudicial demand is *not* therefore essential for the creation of the cause of action to have the period fixed. (*Calero v. Carrion, et al.*, L-13246, Mar. 30, 1960).

(NOTE: In this case, the court said that the prescriptive period is 10 years.)

Example: D wrote a promissory note in C's favor promising payment "little by little." Within 10 years from the date the written contract was perfected, C must bring the action to fix the term. If the period *lapses*, the right to have the court fix the term is considered to have prescribed. (*See Gonzales v. Jose*, 66 Phil. 369).

(6) How the Court Fixes the Period

The Court *determines* the period by considering the time *probably contemplated by the parties*. (Art. 1197). Once the period is fixed by the courts, the period becomes part of the contract, thus the courts cannot change it. (*Ibid.*). The same is true if the period is fixed in a compromise agreement approved by the Court. This is because the compromise agreement acquires the same force and effect as the decision. (*Deudor v. J.M. Tuason & Co., Inc.*, L-13768, May 30, 1961). The parties may of course change the period by mutual agreement, or may even disregard the same (*See Barretto v. City of Manila*, 11 Phil. 624) in which case, the obligation becomes a pure one, and demandable at once. (*See Art. 1197*).

(7) An Example Where the Article Is Not Applicable

Millare v. Hernando GR 55480, Jun. 30, 1987

This Article does not apply to a contract of lease which fixes a period, *e.g.*, an original period of five years, which has expired, and where the parties reserved to themselves the faculty of agreeing upon the period of the renewal contract. It does not also apply if the duration of the renewal period is not left to the will of the lessee alone, but rather to the will of the lessor

and the lessee. Art. 1197 applies only where a contract of lease clearly exists. If the contract is not renewed at all, there could be no contract the period of which could be fixed.

Art. 1198. The debtor shall lose every right to make use of the period:

(1) When after the obligation has been contracted, he becomes insolvent, unless he gives a guaranty or security for the debt;

(2) When he does not furnish to the creditor the guaranties or securities which he has promised;

(3) When by his own acts he has impaired said guaranties or securities after their establishment, and when through a fortuitous event they disappear, unless he immediately gives new ones equally satisfactory;

(4) When the debtor violates any undertaking, in consideration of which the creditor agreed to the period;

(5) When the debtor attempts to abscond.

COMMENT:

(1) When the Debtor Loses the Benefit of the Period

Meaning of “the debtor shall *lose* every right to make use of the period” — the term is extinguished, and the obligation is demandable at once.

(2) Examples

- (a) *Of Par. 1: D owes C P1,000,000 demandable on Jul. 3, 2008. In December, 2004, D became insolvent. The debt is immediately demandable in December, 2004 unless D can offer sufficient security.*

(NOTE: The insolvency referred to does not have to be judicially declared; it is sufficient for him to find a hard time paying off his obligations because of financial reverses that have made his assets less than his liabilities.)

[NOTE: If there happens to be a moratorium law, the debtor who happens to be *insolvent* can still take advantage of said moratorium, which is really a term or an extension of a period, because a moratorium is precisely made to aid those who are insolvent. (See *Timbol v. Martin*, GR L-3469, April 20, 1951).]

- (b) *Of Par. 2:* If a debtor instead of making a mortgage in favor of the creditor, makes it in favor of another person, he fails to furnish the promised guaranties, and he therefore loses the benefit of the term. (*Daguhoy Enterprises, Inc. v. Ponce, et al.*, 96 Phil. 15). The same thing is true if instead of mortgaging to the creditor 3 parcels of land, he mortgages only two of them. (*Laplana v. Garchitorena*, 48 Phil. 163).
- (c) *Of Par. 3:* If a mortgaged house is allowed to decay by the mortgagor, he impairs the value of the guaranty, and therefore the debt becomes demandable immediately. In the same way, if a mortgaged house is completely lost (disappears) in a typhoon, the debt is due at once unless another mortgage equally good is constituted. This is true even if the loss be thru a *fortuitous event*.

Song Fo and Co. v. Oria **33 Phil. 3**

FACTS: Song Fo and Co. sold a launch to the defendant Manuel Oria for P16,000 payable in quarterly installments of P1,000 each. The launch was made security for the debt. Shortly after delivery to Oria, it was shipwrecked in a storm. **Issue:** Should the buyer still pay? If so, when?

HELD: Yes, he must still pay, since the loss of the money (a generic thing) has not been extinguished. Moreover, the whole balance becomes due immediately because the security has disappeared even though thru a *force majeure*, unless he can substitute equally good securities. Hence, the seller can now collect the entire balance.

- (d) *Of Par. 4:* If a condition, such as not to gamble anymore, is violated, any term given because of the condition is lost. If an employee commits a substantial breach of his

employment contract, the employer may terminate the employment, even if there was a fixed duration for the job. (*Marcaida v. Phil. Educ. Co.*, L-9960, May 29, 1957 and *Gonzales v. Haleerer*, 47 Phil. 380). This paragraph was applied by the court in *Corpus v. Alikpala* (L-23707, Jan. 17, 1968).

- (e) *Of Par. 5:* An attempt by the debtor to escape is a sign of bad faith, hence, the loss of the term. Note that it is not essential that there be an *actual absconding*, the intent to do so being sufficient. Upon the other hand, a mere physical leaving, with no intent to defraud, is not sufficient.

(3) How Terms or Periods Are Computed

“When the laws speak of years, months, days or nights, it shall be understood that —

- (a) *years* — are of three hundred sixty-five days each;
- (b) *months* — of thirty days;
- (c) *days* — of twenty-four hours;
- (d) *and nights* — from sunset to sunrise.

“If months are designated by their *name*, they shall be computed by the number of days which they respectively have.”

“In computing a period, the first day shall be excluded and the last day included.” (*Art. 13, Civil Code*).

“In computing any period of time prescribed or allowed by these Rules, or by order of the court, or by any applicable statute, the day of the act or event from which the designated period of time begins to run is to be excluded and the date of performance included. If the last day of the period, as thus computed, falls on a Saturday, a Sunday, or a legal holiday in the place where the court sits, the time shall not run until the next working day.” (*Sec. 1, Rule 22, 1997 Rules of Civil Procedure*).

“Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which time is to begin to run, and by including the day of payment.” (*Sec. 85, Negotiable Instruments Law*).

[NOTE: If a contract stipulated that no payment shall be made until after *one year* from the date of ratification of the Treaty of Peace concluding the Greater East Asia War, but the debt shall be fully paid within a period of *three years* counted from the expiration of the aforementioned one year after the ratification of the treaty, the obligation becomes due four years from *Apr. 28, 1952*, when a majority of the states signatory to the Treaty of Peace ratified the same, or on *April 29, 1956*. The periods fixed in the contract cannot be counted from the ratification by the Philippines of the treaty, because the term “ratification” is used in a general sense without any reference to any specific country; neither should it be counted from the factual termination of the war on Sept. 2, 1945 by the signing of the treaty of surrender of Japan in Tokyo Bay, because the contract expressly mentions “ratification” of the Treaty of Peace concluding the war. (*Arellano v. Tinio de Domingo*, L-8679, Jul. 26, 1957).]

(4) Some Cases

Modesto Soriano v. Carolina Abalos, et al. 84 Phil. 206

FACTS: On Mar. 17, 1938, Juliana Abalos and Carolina Abalos sold a parcel of land to Felipe Maneclang and Modesto Soriano at the price of P750, with option to repurchase the same, “at anytime they have the money.” Offer to repurchase was made in Dec. 1941, but this could not be carried out because of the war. Maneclang, in the meantime, ceded all his rights to Soriano. In May, 1944, offer to repurchase was again made, but Soriano rejected the offer. Because of this, the vendors (Abalos) consigned (deposited) the price of P750 with the court and filed a complaint for repurchase. Soriano refused to accept because according to him there was no express agreement as to the time within which the repurchase could be made and according to the Civil Code, if no time for repurchase is stipulated, only a period of four years is allowed. **Issue:** Does the phrase “at any time they have the money” expressly stipulate a time or not?

HELD: The stipulation in the contract provides that the vendors may repurchase the property “at anytime they have the money.” There is, therefore, a time which is expressly stipulated.

And this is “anytime.” Hence, the period of four years mentioned in the Civil Code for redemption is not applicable. Instead, we apply another provision of the Code which says that if the time given is unlimited or indefinite, the time for redemption cannot exceed ten years. The court cited the following cases to support this contention: *Heirs of Jumero v. Lizares* (31 Phil. 112); *Bandong, et al. v. Austria*, GR 31479, and *Lino Gonzaga v. Juan Co*, GR 47061. Since, therefore, offer to repurchase was made validly in May, 1944, there is no question that redemption can be allowed.

Jose L. Gomez, et al. v. Miguel Tabia
84 Phil. 269

FACTS: A sold B a parcel of land for P5,000 in Japanese money, on Jun. 24, 1944. In the contract it was agreed that within 30 days after the expiration of one year from Jun. 24, 1944, the aforementioned land may be redeemed or repurchased “*sa ganito ding halaga*” (at the same price), and that if this was not done, B would be the absolute owner of said land. Before the expiration of the period but after liberation, A has given B P500, Philippine currency, but B refused, saying that he would accept P5,000, Philippine currency. Both the trial court and the Court of Appeals gave an equivalent value to the P5,000 Japanese money in Philippine currency. B appealed the case to the Supreme Court asking in Philippine currency the price for the redemption. *Issue:* What does the phrase “*sa ganito ding halaga*” means? Should it be P5,000, Japanese money (around P780.26 according to the Ballantyne scale — which has been adopted for equivalents)?

HELD: The meaning of the phrase is P5,000, Philippine currency (and not merely its equivalent), because both parties here speculated on the date of the termination of the war and the liberation of the Philippines, and this kind of contract — aleatory — is allowed.

Section 3

ALTERNATIVE OBLIGATIONS

Art. 1199. A person alternatively bound by different prestations shall completely perform one of them.

The creditor cannot be compelled to receive part of one and part of the other undertaking.

COMMENT:

(1) ‘Alternative Obligation’ Defined

An *alternative* (or *facultative*) obligation is one where out of the two or more prestations which may be given, only one is due.

(2) Example

“A will give *B* this car or this ring or this fountain pen.”
A does not have to give *B* all the three things enumerated. The giving of one is sufficient to satisfy the obligation.

(3) Query

In the example given above, may *A* compel *B* to accept half the car and half the ring (hence, establishing co-ownership between *A* and *B*)?

ANS.: No, *B* cannot be forced to accept. The creditor cannot be compelled to receive part of one and part of the other undertaking.

Art. 1200. The right of choice belongs to the debtor, unless it has been expressly granted to the creditor.

The debtor shall have no right to choose those prestations which are impossible, unlawful or which could not have been the object of the obligation.

COMMENT:

(1) Who Has the Right of Choice

As a *general rule*, the right belongs to the *debtor*. By way of exception it may belong to the creditor when such right has expressly been granted to him.

(2) Example

A is obliged to give B this car or this ring or this cigarette case. Nothing is said in the contract as to who was given the right of choice. Suppose B selects the car, is A bound by the choice made?

ANS.: No, A is not bound by the choice made because it is not B but A who, in the absence of any stipulation, is given the right to choose the object he desires to give.

(3) Query

In what way does an obligation with a term differ from an alternative obligation with reference to benefit?

ANS.: In an obligation with a term, the general rule is that the term is for the benefit of both the debtor and the creditor. In an alternative obligation, however, the general rule is that the debtor has the right of choice.

(4) Some Cases

Agoncillo v. Javier
30 Phil. 124

FACTS: A borrowed money from B. It was agreed that at the maturity of the debt, A will give B either the sum lent or a particular house and lot. *Issue:* Is this stipulation valid?

HELD: Yes, this stipulation is valid because it is simply an alternative obligation, which is expressly allowed by the law. The agreement to convey the house and lot at an appraised valuation in the event of failure to pay the debt in money at its maturity is, however, in our opinion perfectly valid. It is simply an undertaking that if the debt is not paid in money, it will be paid in another way. As the contract reads, the agreement is not open to the objection that the stipulation is a *pacto commisorio*. It is not an attempt to permit the creditor to declare a forfeiture of the security upon the failure of the debtor to pay the debt at maturity. It is simply provided that if the debt is not paid in money it shall be paid in another specific way by the transfer of the property at a valuation. Of course, such an agreement unrecorded, creates no right *in rem*, but as between the parties,

it is perfectly valid, and specific performance by its terms may be enforced unless prevented by the creation of superior rights in favor of third persons.

The contract now under consideration is not susceptible of the interpretation that the title to the house and lot in question was to be transferred to the *creditor ipso facto* upon the mere failure of the debtors to pay the debt at its maturity. The obligations assumed by the debtors were in the *alternative*, and they had the right to elect which they would perform. The conduct of the parties show that it was not their understanding that the right to discharge the obligation by the payment of money was lost to the debtors by their failure to pay the debt at its maturity. The plaintiff (*B*) accepted a partial payment from Anastacio Alano (*A*) in 1908, several years after the debt matured. The prayer of the complaint is to execute a conveyance of the house and lot after its appraisal, unless the defendants pay the plaintiff the debt which is the subject of this action.

It is quite clear, therefore, that under the terms of the contract, as we read it, and the parties themselves have interpreted it, the liability of the defendant as to the conveyance of the house and lot is subsidiary and conditional, being dependent upon their failure to pay the debt in money. It must follow, therefore, that if the action to recover the debt was prescribed, the action to compel a conveyance of the house and lot is likewise barred, as the agreement to make such conveyance was *not* an independent principal undertaking, but merely a subsidiary *alternative pact* relating to the methods by which the debt might be paid.

**Ong Guan Can and Bank of the Phil. Islands
v. Century Insurance Company
46 Phil. 592**

FACTS: *A* insured his house with *B*, an insurance company. The contract stated that if the house is damaged or destroyed, *B* may either pay for the damage or have the house rebuilt in a sufficient manner. **Issue:** Is this an alternative obligation?

HELD: Yes. "It operates to make the obligation of the insurance company an alternative one, that is to say, that it

may either pay the amount in which the house was insured or rebuild it.”

**Equitable Insurance Casualty Co., Inc.
v. Rural Insurance and Surety Co., Inc.
L-17436, Jan. 31, 1962**

The term “facultative” (or “alternative”) used in *reinsurance* contracts, merely defines the right of the reinsurer (one who insures an insurer against loss) to accept or not to accept participation of others in the risk insured. Such a facultative reinsurance contract is *not* the facultative or alternative obligation referred to in the Civil Code.

(*NOTE:* Thus, in a facultative reinsurance, the choice is to *accept* or *refuse*; in a facultative or alternative obligation, there is an *obligation* and the choice is limited to how that obligation may be complied with.)

(5) Limitation on the Debtor’s Choice

The debtor shall have no right to choose those prestations which are:

- (a) impossible
- (b) unlawful
- (c) or which could not have been the object of the obligation.
(*Art. 1200, par. 2, Civil Code*).

(6) Example

A is bound to give B a pack of shabu, or a bottle of milk taken from a goat, or a particular cigarette case, or a particular fountain pen. A cannot choose the *first*, because this would be unlawful; nor the *second*, because this is impossible. A can, therefore, choose only between the *third* and the *fourth*.

Art. 1201. The choice shall produce no effect except from the time it has been communicated.

COMMENT:**(1) Means of Notification or Communication to Other Party of Choice**

Since the law requires no specific form, it is believed the choice can be communicated *orally* or in *writing*, expressly, or impliedly, such as by performance of one of the obligations. (See *8 Manresa 181*).

(2) Effect of Notice that Choice Has Been Made

Once notice has been made that a choice has been done, the obligation becomes a simple obligation to do or deliver the object selected. (*8 Manresa 181*). An election once made is binding on the person who makes it, and he will not, therefore, be permitted to renounce his choice and take an alternative which was first open to him. (*Reyes v. Martinez, 55 Phil. 492*).

(3) Reason for Communicating the Choice to Creditor

In the case of *Ong Guan Can and Bank of the Phil. Islands v. Century Insurance Co., 46 Phil. 592*, the Supreme Court stated that the debtor must notify the creditor “in order to give the creditor opportunity to express his consent or to impugn the election made the debtor.” This is an error because if this were so, the debtor is really being deprived of his right, under the law, to make his own choice. The real purpose of the notice is to inform the creditor that the obligation is now a simple one, no longer alternative, and if already due, for the creditor to receive the object being delivered, if tender of the same has been made.

(4) Requisites for the Making of the Choice

- (a) made *properly* so that the *creditor* or his *agent* will actually know;
- (b) made with *full knowledge* that a selection is indeed being made. (Thus, ERROR in appreciating the meaning of *alternative* obligations will give rise to vitiated consent, and the choice can later on be annulled.);
- (c) made *voluntarily* and *freely* (without FORCE, INTIMIDATION, COERCION, or UNDUE INFLUENCE);

- (d) made in *due time*, that is, *before* or *upon* maturity (otherwise, the creditor can sue him in court with an alternative relief as “give this or that, depending upon your choice”);
- (e) made to all the proper persons (Hence, if there be joint creditors, all of them must be notified.);
- (f) made without conditions unless agreed to by the creditor (otherwise, it can be said that no real choice is being made);
- (g) may be waived, expressly or impliedly (since all rights in general may be waived).

Art. 1202. The debtor shall lose the right of choice when among the prestations whereby he is alternatively bound, only one is practicable.

COMMENT:

When Debtor Loses the Right of Choice

Example:

X is obliged to give Y either object A or object B or object C. If objects A and B are lost by a fortuitous event before choice can be made, X can deliver only object C, because the obligation has become a simple one. If later, object C is also destroyed by a fortuitous event, the obligation is extinguished, and X would not be liable in any way.

**San Jose v. Javier
L-6802, 1954**

A seller had an alternative: either to sell his house *together* with his right of option, *to buy* the land on which it had been constructed, *or to return* the advance payment given by the buyer. If he loses the right to the option, he loses his right to choose the sale of the house.

Art. 1203. If through the creditor's acts the debtor cannot make a choice according to the terms of the obligation, the latter may rescind the contract with damages.

COMMENT:**Rule When Debtor Cannot Choose Because of Creditor's Acts***Example:*

For P200,000 *D* promised to teach *C* mathematics for the year 2005 or to buy for him a state-of-the-art computer notebook. If in 2005, *C* goes to Germany, *D* obviously cannot teach him, and since *D* is deprived of the right to choose because of *C*'s own act (of leaving), *D* may either:

- (a) buy the state-of-the-art computer notebook.
- (b) or *rescind* the contract with the right to recover whatever damages he has suffered.

(NOTE: Please observe that the contract is *not automatically rescinded*; the law says that the debtor "may rescind," implying that he may allow it to remain in force insofar as the possible choice or choices are involved.)

Art. 1204. The creditor shall have a right to indemnity for damages when, through the fault of the debtor, all the things which are alternatively the object of the obligation have been lost, or the compliance of the obligation has become impossible.

The indemnity shall be fixed taking as a basis the value of the last thing which disappeared, or that of the service which last become impossible.

Damages other than the value of the last thing or service may also be awarded.

COMMENT:**(1) Alternative Rights of Creditor When Loss or Impossibility Occurs Before Debtor's Choice**

This Article applies when:

- (a) the right to choose belonged to the debtor;
- (b) and the loss or impossibility happened before selection was made.

(2) Example

- (a) *D* is obliged to give *C*, at *D*'s option, either object No. 1, object No. 2 or object No. 3. If all objects were lost thru *D*'s fault, the value of the *last thing* lost with damages must be given to *C*. This is because if objects Nos. 1, 2, and 3 disappeared *in that order*, upon the loss of objects 1 and 2, the obligations were converted into a simple one, namely to give object No. 3. Thus, it is object No. 3's value which should be taken as a basis.
- (b) In the above example, if objects Nos. 1 and 2 were destroyed by a fortuitous event, and later object No. 3 is destroyed by *D*'s fault, would *D* be liable?

ANS.: Yes, because loss of objects Nos. 1 and 2 converted the obligation into a simple one, and *D* is liable for object No. 3.

- (c) If instead, objects Nos. 1 and 2 were destroyed by *D*'s own fault, and later object No. 3 is lost by a fortuitous event, should *D* be held liable?

ANS.: It is believed that *D* should not be held liable. *D* had all the right in the world to destroy objects Nos. 1 and 2, since he was free *not* to select them. In destroying Nos. 1 and 2 he really made his choice and the obligation to give has become a simple one — to give No. 3. Loss of the object of a simple obligation by fortuitous event should *as a rule* extinguish any liability. (To avoid unfairness, however, it would seem that immediately after the loss of object No. 1 and object No. 2, the debtor must *inform* the creditor of this fact.)

Art. 1205. When the choice has been expressly given to the creditor, the obligation shall cease to be alternative from the day when the selection has been communicated to the debtor.

Until then the responsibility of the debtor shall be governed by the following rules:

- (1) If one of the things is lost through a fortuitous event, he shall perform the obligation by delivering that which the**

creditor should choose from among the remainder, or that which remains if only one subsists;

(2) If the loss of one of the things occurs through the fault of the debtor, the creditor may claim any of those subsisting, or the price of that which, through the fault of the former has disappeared, with a right to damages;

(3) If all the things are lost through the fault of the debtor, the choice by the creditor shall fall upon the price of any one of them, also with indemnity for damages.

The same rules shall be applied to obligations to do or not to do in case one, some or all of the prestations should become impossible.

COMMENT:

(1) Rules When Choice Has Been Given to Creditor

- (a) The Article gives the rules. For the choice to be given the creditor, the right must expressly be given to him. It cannot just be implied. Of course, the communication of choice by him may be *express* or *implied*, such as when suit is made for one of the objects.
- (b) As in the case of the debtor, it should be understood that the creditor loses the right to choose if *only one* of the prestations is practicable. Thus, in a 1951 case, where the creditor was entitled to demand, at maturity, either English currency or the Philippine peso, he could only get the Philippine peso (Japanese notes) because at time of maturity (Feb. 17, 1943) only said currency was available, all others having been outlawed. The debtor's obligation had ceased to be alternative and had become a simple one. (*Legarda, et al. v. Mialhe, GR 3435, Apr. 28, 1951*).
- (c) Art. 1205 *does not apply* when the contract does not state to whom the right to choose is given, for in such case it is the debtor who can choose.

(2) Example

D is obliged to give *C* either object No. 1 or object No. 2 or object No. 3 at *C*'s option. Before *C* communicated his choice to

D, object No. 1 had been destroyed thru *D*'s fault and object No. 2 had been destroyed by a fortuitous event. What are *C*'s rights, if any?

ANS.: *C* can demand:

- (a) either object No. 3 (which is still there);
- (b) or the price of object No. 1 (with damages, in either case, because *C* has been deprived of the right to select).

But *C* cannot ask for the value of object No. 2 since this was lost fortuitously.

(3) Effect if Creditor Delays in Making the Choice

If the creditor delays in choosing, he cannot yet hold the debtor in default, notwithstanding the lapse of maturity, for the debtor does not know what to deliver. Upon the other hand, if the debtor wants to relieve himself, he may petition the court to compel creditor to accept, in the alternative, at the creditor's option, with resultant damages if any.

Art. 1206. When only one prestation has been agreed upon, but the obligor may render another in substitution, the obligation is called facultative.

The loss or deterioration of the thing intended as a substitute, through the negligence of the obligor, does not render him liable. But once the substitution has been made, the obligor is liable for the loss of the substitute on account of his delay, negligence or fraud.

COMMENT:

(1) 'Facultative Obligation' Defined

It is one where only one prestation has been agreed upon but the obligor may render another in substitution.

Example: D promised to give *C* his diamond-studded ring but it was stipulated that *D* could give his BMW car as a substitute.

(2) Distinctions Between the Alternative and the Facultative Obligations

(a) First, by *example*:

- 1) *ALTERNATIVE* — *D* will give object No. 1 or object No. 2. If object No. 1 is lost by a fortuitous event, *D* will still have to give object No. 2.
- 2) *FACULTATIVE* — *D* will give object No. 1 but if *D* wants, he may give object No. 2. If object No. 1 is lost by a fortuitous event, the obligation is extinguished (because the principal object has been lost), and *D* does not have to give object No. 2.

(b) Second, *in theory*.

<i>ALTERNATIVE</i>	<i>FACULTATIVE</i>
(1) Various things are due, but the giving of one is sufficient.	(1) Only one thing is principally due, and it is that one which generally is given, but the other (the substitute) may be given to render payment or fulfillment easy.
(2) If one of the prestations is illegal, the others may be valid and the obligation remains.	(2) If the principal obligation is void, and there is no necessity of giving the substitute. (“The nullity of the principal carries with it the nullity of the accessory or substitute.” — this principle may by analogy be applied.)
(3) If it is impossible to give all except one, that last one must still be given.	(3) If it is impossible to give the principal, the substitute does not have to be given; if it is impossible to give the substitute, the principal <i>must still</i> be given.
(4) The right to choose may be given either to <i>debtor</i> or <i>creditor</i> .	(4) The right of choice is given <i>only</i> to the debtor. (<i>See 8 Manresa 170</i>).

Quizana v. Redugerio and Postrado
94 Phil. 218

FACTS: The parties agreed that in case the borrower, in a contract of loan, cannot pay the indebtedness on the date specified, the borrower should mortgage a parcel of land to secure said obligation.

HELD: The stipulation is valid and effective and is known as a *facultative obligation*. This is a new provision and is not found in the old Civil Code in force in 1948, when the agreement was entered into. Nevertheless, since the agreement is not contrary to public morals or public policy, the mere absence of any legal provisions governing it at the time it was entered into is of no moment, and there is no reason why it should not be given effect.

(3) Query

The law says that “the loss or deterioration of the thing intended as a substitute, thru the *negligence* of the obligor, does not render him liable.” (This is because the debtor can always select the *principal*, and not necessarily the substitute. And it is understood that the sentence above applies *before* choice has been made.) Suppose instead of loss thru “negligence,” loss of the *substitute* was done deliberately should the debtor be now held liable?

ANS.: Still no, since he can always comply with the principal obligation.

Section 4

JOINT AND SOLIDARY OBLIGATION

Art. 1207. The concurrence of two or more creditors or of two or more debtors in one and the same obligation does not imply that each one of the former has a right to demand, or that each one of the latter is bound to render, entire compliance with the prestation. There is a solidary liability only when the obligation expressly so states, or when the law or the nature of the obligation requires solidarity.

COMMENT:**(1) Joint Distinguished from Solidary Obligations**

In a joint obligation “each obligor answers only for a part of the whole liability and to each obligee belongs only a part of the correlative rights.” Whereas, in “a solidary or joint and several obligation, the relationship between the active and the passive subjects is so close that each of the former or of the latter may demand the fulfillment of or must comply with the whole obligation.” (8 *Manresa* 194). Stated otherwise, the following are the maxims to remember:

- (a) Joint Obligations — “To each his own.”
- (b) Solidary Obligations — “One for all, all for one.”

(2) Examples

For Joint Obligations:

- (a) *A* and *B* are joint debtors of *C* to the amount of P1,000,000. *C* can demand only P500,000 from *A*, and only P500,000 from *B*.
- (b) *A* and *B* are joint debtors of *C*, *D*, *E*, and *F*, who are joint creditors to the amount of P1,000,000. *C* may demand only P125,000 from *A*, and P125,000 from *B*. *D*, *E*, and *F*, have the same rights as *C*.

For Solidary Obligations:

- (a) *A* and *B* are *solidary* debtors of *C* to the amount of P1,000,000. *C* can demand the whole P1,000,000 from *A*. *A* in turn, after paying *C*, can ask reimbursement from *B* to the amount of P500,000.
- (b) *A* and *B* are solidary debtors of *C*, *D*, *E*, *F*, solidary creditors, to the amount of P1,000,000. Any creditor, like *C*, can demand from any debtor, like *A*, the whole P1,000,000. In turn, *C* has to give P250,000 each to *D*, *E*, and *F*. *B* has to reimburse *A* for P500,000 which is really *B*’s share of the obligation.

(3) General Rule and Exceptions

Where there are two or more debtors or two or more creditors, the obligation is:

*General Rule — Joint**Exceptions —*

- (a) when there is a stipulation in the contract that the obligation is solidary
- (b) when the nature of the obligation requires liability to be solidary
- (c) when the law declares the obligation to be solidary

(4) Some Instances Where the Law Imposes Solidary Liability

- (a) obligations arising from tort
- (b) obligations arising from quasi-contracts
- (c) legal provisions regarding the obligations of devisees and legatees
- (d) liability of principals, accomplices, and accessories of a felony
- (e) bailees in *commodatum*

(5) Query

May the obligation be joint on the side of the creditors and solidary on the side of the debtors or *vice-versa*?

ANS.: Yes. "In such cases, the rules applicable to each subject of the obligation should be applied, the character of the creditors or the debtors determining their respective rights and liabilities." (8 *Manresa*, pp. 201-202).

Examples:

- (a) *A* and *B* are joint debtors of *C*, *D*, *E*, and *F*, solidary creditors to the amount of P1,000,000. How much can *C* collect from *A*?

ANS.: *C* is a solidary creditor, so presumably he can collect the whole debt. But since *A* is only a joint debtor, *C* is entitled to collect only P500,000 from *A*.

- (b) *A and B are solidary debtors of C, D, E, and F, joint creditors to the amount of P1,000,000. How much can C recover from A?*

ANS.: Since *C* is only a *joint creditor*, he can only recover his share which is P250,000 from *A*, a solidary debtor.

(*NOTE:* Had *C* been solidary creditor, he could have recovered P1,000,000 from *A*; had *A* been a joint debtor, and *C*, also a joint creditor, *C* could have recovered only P125,000 from *A*.)

(6) Some Decided Cases

Uk Pa Leung v. Nigorra **9 Phil. 381**

FACTS: The defendants, as partners in the management of a bakery, owed the plaintiff the amount of P43.35. The trial court ordered each of the defendants liable for the whole amount (*in solidum*). Nigorra appealed this point. *Issue:* In the absence of any fact or law which would make the defendants solidarily liable, are they jointly or solidarily responsible?

HELD: The presumption is that they are only jointly liable. Hence, Nigorra should pay only half of the debt.

Pimentel v. Gutierrez **14 Phil. 49**

FACTS: Three persons signed a contract. No words were used to make each liable for the whole amount.

HELD: Each one is liable only for his proportion or *aliquot* share of the obligation. "If three persons sign a contract under the provisions of the Civil Code, and no words are used to make each liable for the full amount, each is only liable for the proportionate amount of the contract. From a reading of the contract in question, it will be seen that it is *una obligacion mancomunada y no solidaria* and that the three debtors are not liable separately for the payment of the whole amount. They are each liable for an *aliquot* part of the original obligation."

De Leon v. Nepomuceno and De Jesus
37 Phil. 180

FACTS: In an election contest, the protestee and the intervenor were sentenced to pay the costs and expenses of the contest. *Issue:* Is the obligation joint or solidary?

HELD: The obligation is joint. "A final judgment for costs and expenses in an election contest providing that the costs and expenses of the intervenor is a joint and NOT a joint and several judgment for costs and expenses." "If a judgment does not specify how certain debtors are bound it is presumed that they are bound 'jointly' and not 'solidarily'." (*Uk Pa Leung v. Nigorra*, 9 Phil. 381; *Floriano v. Delgado*, 11 Phil. 154; *White v. Enriquez*, 15 Phil. 113; *De Leon v. Nepomuceno and De Jesus*, *supra*).

Parot v. Gemora
7 Phil. 94

FACTS: Two people borrowed money and signed a promissory note promising to pay "*juntos o separadamente*." Are they jointly or solidarily liable?

HELD: They are solidarily liable. "We are of the opinion, and so hold that the phrase '*juntos o separadamente*' used in this promissory note, is an express statement, making each of the persons who signed it individually liable for the payment of the full amount of the obligation contained therein. The phrase *juntos o separadamente* used in a contract creates the same obligation as the phrase *mancomun o insolidum*. The words '*separadamente*' and '*insolidum*' used in a contract in connection with the nature of the liabilities of the parties are sufficient to create an individual liability."

Calo, Jr. v. Cabanos
L-19704, Oct. 19, 1966

If a father is a debtor and he dies, his heirs, up to the value of the inheritance, are liable. Thus, before the heirs share in the inheritance, the debt must first be paid. Thus also, it is not accurate to say that the heirs are solidarily liable for the debt of their father.

Oriental Commercial Co., Inc. v. Felix Lafuente
(C.A.) 38 O.G. 947

FACTS: To guaranty the obligation incurred by Felix Lafuente, a group of men executed a bond in favor of the Oriental Commercial Co., where they promised to answer “individually and collectively for the total amount.” *Issue:* Are the sureties here jointly or solidarily liable?

HELD: They are solidarily liable, and everyone is individually responsible for the full payment of the obligation.

Worcester v. Ocampo, et al.
22 Phil. 42

FACTS: *A* and *B* were both responsible in causing an injury to *C* through their (*A*’s and *B*’s) negligence. *C* brought an action against both. *A* maintains that his liability is only joint, not solidary. *Issue:* Are joint tortfeasors (those liable for a tort) jointly or solidarily liable?

HELD: They are solidarily liable. “If several persons jointly commit a tort, the plaintiff or the person injured has his election to sue all or some of the parties jointly, or one of them separately because the tort is in its nature a separate act of each individual. (*1 Chidey, Common Law Pleadings* 86). It is not necessary that the cooperation should be a direct, corporeal act. It may be stated as a general rule that joint tortfeasors are all the persons who command, instigate, promote, encourage, advise, countenance, cooperate, aid or abet the commission of a tort or who approve of it after it is done. They are each liable as principals, to the same extent, and in the same manner as if they had performed the wrongful act themselves.” (*Cooley on Torts*, 133; *Moir v. Hopkins*, 16 Ill. 313).

Abella v. Co Bun Kim, et al.
100 Phil. 1019

ISSUE: What is the liability of a debtor and the receiver of his property (as assignee in insolvency) — joint or solidary?

HELD: The rules concerning joint and solidary obligations (*obligaciones mancomunadas y obligaciones solidarias*) require

a plurality of subjects (creditors, debtors, or both), and have *no* application when there is only one creditor and one debtor, even if payment is to be made by several individuals, representing one and the same interest or debtor. Thus, the liability of a debtor and the receiver of his property in a litigation cannot be said to be joint or solidary because the receiver does *not* represent an interest completely distinct and separate from the owner of the property, but is merely the custodian of the property, and an extension of the personality of the latter.

Tamayo v. Aquino
L-12634-12720, May 29, 1959

FACTS: A, registered operator (in the Public Service Com.) of a common carrier, sold the vehicle to B without prior approval of the Commission. B then operated the vehicle. An accident took place one day, injuring a *passenger of B*. *Issue:* Are A and B jointly or solidarily liable?

HELD: Only A, the registered owner is liable, but he can recover indemnity from B. Since only one is liable, the distinction between joint and solidary liability does not *exist*. A is liable as a result of the *culpa contractual* (not *culpa aquiliana*) because the vehicle was still registered under his name. This is true even if the property had already been sold to another at the time the accident took place. If the rule were otherwise, a registered owner can easily evade responsibility by *collusion* with others who may possess no property to answer for the damages. (See *Erezo v. Jepte*, GR L-9605, Sept. 30, 1957).

NOTE: In *Caners, et al. v. Arias, et al.*, (Court of Appeals) GR L-24881-R, March 4, 1961, it was held that if the vehicle which figured in an accident was operated under the so-called “*kabit system*,” the award of *exemplary damages*, among others, payable *jointly and severally* by the operator and the grantee of the certificate of public convenience is justified. This pernicious system is not only a violation of law but a fraud upon the travelling public, which has a right to expect that the holder of the certificate be the one to actually operate his transportation line, hire the drivers, and other employees and exercise the necessary supervision over them.

Jereos v. Court of Appeals
L-48747, Sept. 30, 1982

In a civil action due to a quasi-delict (*culpa aquiliana*), the *registered owner*, the *actual owner*, and the *driver* of the jeep involved are solidarily liable. (See *Erezo v. Jepte*, 102 Phil. 103; *Tamayo v. Aquino*, 105 Phil. 949; and *De Peralta v. Mangusang*, 120 Phil. 582).

Fe Perez v. Josefina Gutierrez, et al.
L-30115, Sept. 28, 1973

FACTS: Gutierrez, holder of a certificate of public convenience and authorized to operate an auto-*calesa* in the province of Davao, sold the vehicle to Alajar. The sale, at the time of the accident, had not been approved by the Public Service Commission, and was therefore not registered with such Commission. Later, thru the reckless imprudence of its driver, Cordero, the vehicle met an accident resulting in injuries to Perez, one of its passengers. *Issue:* Who should be held liable to Perez?

HELD: The registered owner, Gutierrez, should be the one directly liable to Perez (See *Erezo v. Jepte*) despite the transfer of the vehicle to another. In dealing with vehicles registered under the Public Service Law, the public has right to presume that the registered owner is the actual owner thereof, for it would be difficult for the public to enforce the action for damages for injuries caused to them by vehicles being negligently operated, if the public should be required to prove who the actual owner is. The transferee, however, should in turn be responsible to the registered owner for in operating the vehicle without its transfer having been approved by the Public Service Commission, the transferee acted merely as an agent of the registered owner and should be responsible to him. The driver should also be held liable solidarily with Gutierrez to Fe Perez in accordance with the provisions of Art. 2184 in relation to Art. 2180 of the Civil Code. (*NOTE:* The driver was also held liable on the basis of a quasi-delict, there being no contractual relation between him and the passenger.)

Gonzales v. Halili, et al.
L-11521, Oct. 31, 1958

The liability of two motor vehicle drivers convicted for injuries thru reckless imprudence is *solidary*. Consequently, the employer of each of them is also *solidarily* liable with respect to his subsidiary liability, as said liability must necessarily be co-extensive with the judgment against his employee.

Republic Planters Bank v. CA
GR L-93073, Dec. 21, 1992

In the case at bar, the solidary liability of private respondent Fermin Canlas is made clearer and certain, without reason for ambiguity, by the presence of the phrase “joint and several” as describing the unconditional promise to pay to the order of Republic Planters Bank.

A joint and several note is one in which the makers bind themselves both jointly and individually to the payee so that all may be sued together for its enforcement, or the creditor may select one or more as the object of the suit. A joint and several obligation in common law corresponds to a civil law solidary obligation, *i.e.*, one of several debtors bound in such wise that each is liable for the entire amount, and not merely for his proportionate share. By making a joint and several promise to pay to the order of Republic Planters Bank, private respondent Canlas assumed the solidary liability of a debtor and the payee may choose to enforce the notes against him alone or jointly with defendant Shozo Yamaguchi and Pinch Manufacturing Corp. as solidary debtors.

As to whether the interpolation of the phrase “and (in) his personal capacity” below the signatures of the makers in the notes will affect the liability of the makers, the Court does not find it necessary to resolve and decide, because it is immaterial and will not affect the liability of private respondent Canlas as a joint and several debtor of the notes. With or without the presence of said phrase, private respondent Canlas is primarily liable as a co-maker of each of the notes and his liability is that of a solidary debtor.

Art. 1208. If from the law, or the nature or the wording of the obligations to which the preceding article refers the contrary does not appear, the credit or debt shall be presumed to be divided into as many equal shares as there are creditors or debtors, the credits or debts being considered distinct from one another, subject to the Rules of Court governing the multiplicity of suits.

COMMENT:

(1) Presumption That Obligation Is Joint

This Article gives us the *presumption* that when there are two or more debtors, or two or more creditors, the obligation is joint and as a consequence:

- (a) The debt shall be divided into as many shares as there are creditors or debtors.
- (b) The credits or the debts will be distinct from one another, BUT regarding the bringing of the action in court, the Rules of Court governing the multiplicity of suits will be followed.

(2) Distinct Shares

In joint obligations, the different shares of the debt or the credit are considered distinct from one another. But they are subject to the Rules of Court governing the multiplicity of suits. This means that ordinarily one creditor may sue one of the debtors for the latter's share of the obligation. But, in view of the fact that the aim of the Rules of Court is to obtain a just, speedy, and inexpensive determination of every action or proceeding, it would be much better to sue all the necessary parties at the same time.

(3) Some Decided Cases

Compania General de Tabacos v. Obed
13 Phil. 391

FACTS: A mother and her son borrowed money. Nothing was said in the contract regarding solidary liability. But in the brief presented by the lawyer for mother and son, the two debtors unwittingly said they were solidarily liable. *Issue:* Does the

statement in the brief of the lawyer convert the joint obligation into a solidary one?

HELD: No. The statement in the brief is immaterial. What must prevail is the contract in question, and since nothing is mentioned therein relating to solidarity, the obligation is only joint.

Oriental Commercial Co. v. Abeto
60 Phil. 723

FACTS: *A* borrowed money from *B* on the strength of two sureties, *C* and *D*, who assumed *joint and several* liability with *A*. The trial judge, upon non-payment of the debt, rendered a judgment against all the defendants (*A*, *C*, *D*) for the total amount sought by *B*. But the judgment did not state whether the liability of the defendants was joint or solidary. *B* then asked for execution on the properties of *C*, one of the sureties for the *whole* obligation. **Issue:** In the contract, liability was solidary but in the judgment, nothing was said about the nature of the obligation, hence it is now merely joint and not solidary. How will the obligation now be considered: joint as in the judgment, or solidary as in the contract?

HELD: The obligation should now be considered as merely a joint one; hence, *B* can get from the properties of *C* only the proportional share of *C*. The judgment did not state that the obligation was joint and several, so none of the defendants may be required to pay for the *whole* obligation. It does not matter that under the provisions of the written contract entered into by the parties the obligation contracted by the sureties was solidary. It must be remembered that there was no appeal from said judgment, and hence the judgment was final. Since the final judgment superseded the action brought for the enforcement of said contract and since it implicitly declared the obligation to be joint and not solidary, it follows that said final judgment cannot be executed otherwise. Hence, it should be executed as imposing merely joint liabilities.

Purita Alipio v. CA
GR 134100, Sept. 29, 2000

FACTS: The trial court ordered petitioner and the Manuel spouses to pay private respondent the unpaid balance of the

agreed rent in the amount of P50,000 without specifying whether the amount is to be paid by them jointly *or* solidarily.

HELD: If from the law or the nature or the wording of the obligation the contrary does not appear, an obligation is presumed to be only joint, *i.e.*, the debt is divided into as many equal shares as there are debtors, each debt being considered distinct from one another. (*See Art. 128*).

(4) Synonyms

(a) For *joint* obligation

- 1) *mancomunada*
- 2) *mancomunada simple*
- 3) *proportionate*
- 4) *pro rata*

(b) For *solidary* obligation

- 1) joint and several
- 2) *in solidum*
- 3) *mancomunada solidaria*
- 4) *juntos o separadamente*
- 5) individually and collectively
- 6) each will pay the *whole* value

[NOTE:

- (a) “We promise to pay,” when there are two or more signatures = *joint* liability.
- (b) “I promise to pay,” when there are two or more signatures = *solidary* liability.

(*See Parot v. Gemora, 7 Phil. 94, supra.*)]

(5) Some Consequences of Joint Liability

- (a) Vitiating consent on the part of one debtor does not affect the others.

Example: A and B are joint debtors of C for P1,000,000. A’s consent was obtained by C thru fraud. B would still be

liable for P500,000, while *A* will not be liable, since the 2 debts are considered distinct from each other.

- (b) *Insolvency* of one debtor does not make others responsible for his share.

Example: *A*, *B*, and *C* are joint debtors of *D* for P3,000,000. If *A* is insolvent, how much should *B* pay *D*?

ANS.: Only P1,000,000, his own proportionate share.

- (c) Demand by the creditor on *one* joint debtor puts him in default, but *not* the others since the debts are distinct.
- (d) When the creditor interrupts the running of the prescriptive period by demanding judicially from one, the others are not affected. (Therefore, it is possible that the share of one joint debtor has not prescribed, while those of the others have already prescribed.) (*Agoncillo & Marino v. Javier*, 38 Phil. 424 and 1 Geogi 83; 33 Dallos 297).
- (e) Defenses of one debtor are not *necessarily* available to the others. (*See 8 Manresa 200-201*).

(6) Liabilities of Partners

- (a) If it arises out of a contract, the liability is *joint* or *pro rata*. (*Art. 1816, Civil Code*). *Exception* – if the dependents of an employee claim compensation for the employee's death in line of duty. (*Liwanag, et al. v. Workmen's Compensation Commission*, GR L-12164, May 22, 1959).
- (b) If it arises out of a *crime* or a *quasi-delict*, the liability is *solidary* (*together with the partnership*). (*Arts. 1822, 1823 and 1824, Civil Code*).

Liwanag, et al. v. Workmen's Compensation Commission L-12164, May 22, 1959

FACTS: Roque Balderama, a security guard of a partnership, the Liwanag Auto Supply, was killed in line of duty. His heirs claim compensation under the Workmen's Compensation

Act. *Issue:* The Act being silent on the point, what is the liability of the partners — joint or solidary?

HELD: Solidary. It is true that ordinarily, the liability of partners is only joint, but this should *not* apply to a case of compensation for death in line of duty. Arts. 1711 and 1712 of the Civil Code, taken together with Sec. 2 of the Workmen's Compensation Law, reasonably indicate that in compensation cases, the liability of business partners should be solidary, otherwise the right of the employee may be defeated, or at least crippled. If the responsibility of the partners were to be merely joint and not solidary, and one of them happens to be insolvent, the amount awarded would only be partially satisfied. This is evidently contrary to the intent and purposes of the Act, which is to give full protection to the employees.

(7) Liabilities of Agents

In general — joint, even if appointed at the same time, unless solidarity has been agreed upon. (*Art. 1894, Civil Code*).

(8) Liabilities of Co-Principals (In Agency)

Solidary.

(9) Liabilities of Husband and Wife

After conjugal funds have been *exhausted*, the husband and the wife are liable *jointly* to creditors of the conjugal partnership. (Here the rules of partnership are suppletorily applicable.) (*See Art. 147, Civil Code*).

(10) Liabilities of Violators of Arts. 19, 20, 21, 22 (on Human Relations) of the Civil Code

Although the law does not expressly say so, it is believed that infractors thereof should be held liable *in solidum*, considering the fact that said violations are either penal in nature or contrary to morals. These are perhaps cases where there is solidarity because of the nature of the obligation. (*See Art. 1207, Civil Code*).

(11) Liabilities of Employer and Employee for the Latter's Tortious Act

Here, the liability of an employer is *primary* (not subsidiary), and *solidary* with that of the employees. (*Arts. 2180 and 2194, Civil Code*). However, if the injured party does *not* appeal from an erroneous judgment holding the liability to be merely subsidiary, instead of solidary, the same becomes *res judicata*, and the obligation ceases to be solidary. (*Bachrach Motor Co. v. Gamboa, L-10296, May 21, 1957*).

(12) Query

If a contract states “Jose or Maria will pay you P1,000,000” (disjunctive obligations), should this be considered *alternative*, *joint*, or *solidary*?

ANS.: It really depends upon the intention of the parties. Hence, if what is intended is to have the obligation satisfied in full, the payer being immaterial, the courts may be inclined to consider the same as *solidary*, with the creditor being given the right to select who would pay, and in case of partial performance merely, he can still ask the other for the balance.

Art. 1209. If the division is impossible, the right of the creditors may be prejudiced only by their collective acts, and the debt can be enforced only by proceeding against all the debtors. If one of the latter should be insolvent, the others shall not be liable for his share.

COMMENT:**(1) Indivisible Joint Obligation**

This Article speaks of an *indivisible joint* obligation (indivisible — referring to the OBJECT; joint — referring to the TIE between the parties, who are merely proportionately liable, unless solidarity has been stipulated by the parties or the law, in which case, it is called a *solidary indivisible* obligation).

(2) Example of a Joint Indivisible Obligation

A and *B* are jointly liable to give *C* this particular car.

(3) Manresa's Comment

“The obligation is in a sense midway between the joint and the solidary, although it preserves the two characteristics of the joint obligation in that: (a) no creditor can do an act prejudicial to the others, and (b) no debtor can be made to answer for the others. The peculiarity of this obligation, however, is that its fulfillment requires the consent of all the debtors, although each for his part. On the side of the creditors, collective action is also required for acts which may be prejudicial.” (8 *Manresa* 197).

(4) Characteristics

- (a) The obligation is *joint* but since the object is indivisible, the creditor must proceed against ALL the joint debtors (*Art. 1209*), for compliance is possible only if all the joint debtors would act TOGETHER.
- (b) Demand must, therefore, be made on ALL the joint debtors.
- (c) If any one of the debtors does not comply with his monetary obligation for damages. (*Art. 1224, Civil Code; 8 Manresa 237-238*).
- (d) If any of the joint debtors be insolvent, the others shall not be liable for his share. (*Art. 1209, Civil Code*).

(NOTE: The obligation to pay monetary damages is of course *no longer indivisible*, and therefore, the creditor may go against each debtor individually, subject to the provisions of the Rules of Court.)

- (e) If there be joint creditors, delivery must be made to all, and not merely to one, unless that one be specifically authorized by the others.
- (f) Each joint creditor is allowed to renounce his proportionate credit.

(5) Example

A, B, and C are jointly liable to give a particular car worth P1.2 million in favor of D, E, F, and G. A is insolvent and the

debtors, therefore, cannot purchase the car to give to the creditors. *D* and *E* have renounced their rights. The debtors are not in default. How much can each of the creditors get from each of the debtors?

ANS.: Since this is a joint and indivisible obligation and since the car cannot be given, it is converted into an obligation to give indemnity for damages. Since this is a joint obligation, each debtor is proportionately liable and each creditor is only entitled to his proportional credit.

P1.2M divided by 3 = P400,000 (the total debt of *each* debtor)

P 400,000 divided by 4 = P100,000 (the credit belonging to each joint creditor, not from each joint debtor).

A is insolvent, and his share will *not* be included in the liability of *B* and *C*.

Therefore:

- (a) *D* and *E* having renounced their rights, they get *nothing*.
- (b) *F* has *not* renounced his right, so he can get P100,000 from *B* and P100,000 from *C*. Over *A*, *F* has the rights of creditor over an insolvent debtor.
- (c) *G* has exactly the same rights as *F*.

(6) A Demand by One Joint Creditor Is Not a Demand by the Others

In a joint indivisible obligation, if *one* of the joint creditors makes a demand upon one of the debtors, there is no doubt that the debtor is in default with reference to the demanding creditor's share. Is she also in default with reference to the others?

ANS.: Although it would seem that the answer is *YES*, because this act *benefits*, and *does not prejudice* the others, and is therefore implicitly what the law provides (*See 8 Manresa 197*), still it should be borne in mind that the credits are still *independent* of one another (*See by analogy from the decision of the Supreme Court of Louisiana, Buard v. Lemes Syndic., 12*

Robinson's Reports, p. 243), and, therefore, the answer should be *NO*.

Art. 1210. The indivisibility of an obligation does not necessarily give rise to solidarity. Nor does solidarity of itself imply indivisibility.

COMMENT:

(1) Indivisibility as Distinguished from Solidarity

Indivisibility — refers to the *Subject Matter*

Solidarity — refers to the *Tie between the Parties*.

(Hence, the two are not the same.)

(2) Examples

- (a) Joint divisible obligation — *A* and *B* are jointly liable to *X* for P1 million.
- (b) Joint indivisible obligation — *A* and *B* are jointly liable to give *X* this car.
- (c) Solidary divisible obligation — *A* and *B* are solidarily bound to give *X* P1 million.
- (d) Solidary indivisible obligation — *A* and *B* are solidarily bound to give *X* this car.

(3) The Different Kinds of Solidarity

First classification:

- (a) *Active solidarity* — on the part of the creditors or obligees
- (b) *Passive solidarity* — on the part of the debtors or obligors
- (c) *Mixed solidarity* — on the part of the obligors and obligees, or on the part of the debtors and the creditors

Second classification:

- (a) *Conventional solidarity* — agreed upon by the parties
- (b) *Legal solidarity* — that imposed by the law

Art. 1211. Solidarity may exist although the creditors and the debtors may not be bound in the same manner and by the same periods and conditions.

COMMENT:

(1) Solidarity Despite Different Terms or Conditions

- (a) According to Sanchez Roman, what are the different ways by which two debtors may be bound?

ANS.:

- 1) *Uniform* — when the debtors are bound by the same stipulations and clauses;
 - 2) *Otherwise* — where the obligors though liable for the same prestation, are nevertheless not subject to the same secondary stipulations and clauses. (*4 Sanchez Roman 50*).
- (b) *Example of a case when solidarity may exist even when the creditors and the debtors are not bound in the same manner:*

A and B solidarily bound themselves to pay a total of P1,000,000 to C, D, and E subject to the following conditions and terms: C's share will be due at the end of the year; D will get his share only if he passes the bar; and E will get his share only after he (E) has painted the house of X. Here, the obligation is still solidary.

- (c) In the example given in (b), when will this solidary obligation be due and demandable?

ANS.: The obligation is still solidary but C's share will only be due and demandable at the end of the year, and E and D's shares will be due and demandable only upon the fulfillment of the condition.

Supposing the obligation is to be subject to different terms and conditions, the following is the solution: the creditor may recover that part which is pure and unconditional, and should leave in suspense or pending, the right to demand the payment of the remainder until the expiration of the term or the fulfillment of the condition. Solidarity

is still preserved by recognizing in the creditor the power, upon the fulfillment of the condition or the expiration of the term, of claiming from any or all of the debtors, that part of the obligation effected by these conditions.” (*Scaevola,Codigo Civil Comentado y Concordado, Vol. 19, pp. 800-801*).

(2) Case

Inchausti & Co. v. Yulo **34 Phil. 978**

FACTS: *A, B, C, D, and E* borrowed money from *F*. The contract stipulated solidary one, and the debtors were bound under different terms and conditions. *F* brought an action to recover from *A*, whose obligation was already due. *A* claims that he cannot be made to pay because the obligations incurred by his solidary co-debtors were not yet due. **Issue:** When the debtors of a solidary obligation are bound by different terms and conditions, may the creditor sue one of them?

HELD: Yes, the creditor may sue the one whose share has already become due and demandable but the creditor cannot recover yet from the debtor sued, the shares of the other debtors, until the conditions or terms of the others have already been fulfilled. In other words, *F* may recover now from *A* only *A*'s share; and when the conditions and terms have been fulfilled for the shares of *B, C, D, and E*, the creditor *F* can recover their shares from *A*. This, after all, is still a solidary obligation.

(3) Problem

In 2004, *A, B, and C* bound themselves *in solidum* to give *X* P300,000 subject to the following stipulations: *A* to pay in 2005; *B*, if he passes the bar; *C*, in 2007.

(a) In 2005, how much can *X* demand from *A*?

ANS.: Only P100,000. Since this is solidary, *X* has a right to P300,000 (the whole) MINUS *B*'s share of P100,000 and *C*'s share of P100,000, or a total of only P100,000. In 2007, *X* can collect from *A* the P100,000 corresponding to *C*. The moment *B* passes the bar, *X* can also collect from *A, B*'s share of P100,000.

- (b) Suppose *X* instead made a demand on *C* in 2005, how much can he collect from *C*?

ANS.: Only P100,000, the share corresponding to *A*, because *C*'s own share has not yet matured and *B* has not yet passed the bar.

[NOTE: In both problems, the rule is that the whole solidary obligation can be recovered from ANY of the solidary debtors MINUS the share of those with unmatured conditions or terms. (See 8 Manresa 203).]

Art. 1212. Each one of the solidary creditors may do whatever may be useful to the others, but not anything which may be prejudicial to the latter.

COMMENT:

Solidary Creditors May Do Useful, Not Prejudicial Acts

- (a) *Example of Beneficial Act* — To interrupt the running of prescription, the act of one solidary creditor in making a judicial demand upon any of the solidary debtors is sufficient. The law provides that: "The prescription of actions is interrupted when they are filed before the Courts." (Art. 1155, 1st clause, Civil Code).
- (b) *Prejudicial Acts* — should not be performed, otherwise, there will be liability for damages. However, in the case of remission or condonation (which is really prejudicial), the solidary creditor is allowed to so remit, and the obligation is extinguished, *without prejudice* to his liability to the other creditors. (See Art. 1215, Civil Code).

Art. 1213. A solidary creditor cannot assign his rights without the consent of the others.

COMMENT:

(1) General Rule About Non-Assignment of Rights by Solidary Creditor

The solidary creditor *cannot* assign his rights.

Exception:

He is allowed if all the others consent.

Reason for the Law:

Essentially, a solidary obligation implies mutual agency and mutual confidence. Should the assignee or substitute do acts which would prejudice the others (as when he absconds after receiving payment), there is no doubt that the other creditor's right are endangered, hence, the necessity of their consent.

(2) Criticism by Justice J.B.L. Reyes

“The rule (of non-assignment without the other's consent) is JUSTIFIABLE and places an unnecessary restriction on the rights of the solidary co-creditors upon his share. The reason behind it seems to be that each creditor represents the others and, therefore, must have the confidence of the latter. But in the first place, confidence between co-creditors cannot properly be said to exist *except* in the case of a solidary credit by contract (note that the law is the one that imposes solidarity in some obligations, not the mutual agreement of the parties). In the second place, representation (by each creditor) of the solidary creditors is created by law and not by consent or agreement of the parties. If danger is seen in the possible misfeasance of the assignee, the remedy is not the paralyzation of the proprietary rights to the solidary creditor, but to impose upon him a *subsidiary responsibility* for the acts of the assignee, similar to that of the agent for the acts of sub-agent under *Art. 1892*.” This is Manresa's view in his comment to *Art. 1141* of the Code of 1889. So that *Art. 1213* should have been made to read: “A solidary creditor who assigns his rights without the consent of his co-creditors shall answer subsidiarily for any prejudice caused to the latter by the assignee in connection with the credit.” (*Lawyer's Journal, Observations on the new Civil Code, Jan. 31, 1951, p. 48*).

Art. 1214. The debtor may pay any one of the solidary creditors; but if any demand, judicial or extrajudicial, has been made by one of them, payment should be made to him.

COMMENT:**(1) To Whom Debtor Must Pay**

- (a) to *any* of the solidary creditors
- (b) *exception* — payment must be made to solidary creditor who made a demand (*judicial or extrajudicial*)

(2) Problems

- (a) *A* and *B* are solidary debtors of *C*, *D*, and *E*, solidary creditors. May *A* pay *C* the *whole* obligation?

ANS.: Yes, provided, no *judicial* or *extrajudicial* demand had been made by either *D* or *E*.

- (b) *A* and *B* are solidary debtors of *C*, *D*, and *E*, solidary creditors. *E* makes judicial demand. There is no extrajudicial demand upon *A*. To whom should *A* pay?

ANS.: Only *E*, who had made the judicial demand. Payment to any other creditor will not extinguish the obligation except insofar as the payee's share is concerned.

- (c) *A* and *B* are solidary debtors of *C*, *D*, and *E*, solidary creditors. *C* makes a judicial demand on *A*. Can *D* and *E* sue *A*?

ANS.: In the meantime, no, because *C* is supposed to be representing already *D* and *E*. If judgment is rendered against *A*, and *A* does not have enough money, then *D*, *E*, or *C* (individually or collectively) may still sue *B* for the remainder. But it is essential that the first action be first terminated.

- (d) *A* and *B* are solidary debtors of *C*, *D*, and *E*. *C* makes an *extrajudicial* demand upon *A*, who does not pay. Can *D* and *E* sue (judicial demand) *A*?

ANS.: Although strictly speaking, the answer may be in the NEGATIVE since under the law payment must be made to *C*, who had made the extrajudicial demand, still the law should not be construed to effect an *absurdity* in that *D* and *E* would be compelled to *just stand by idly*, since *C* does not institute any judicial action. Since *C*'s act

(or inaction) is prejudicial to *D* and *E*, the two (*D* and *E*) should be allowed to make the judicial demand. (See Art. 1212, *Civil Code*).

- (e) *A* and *B*, solidarily debtors, are indebted to *C*, *D*, and *E*, solidary creditors. *C* extrajudicially demands from *A*, but *B* (upon whom no demand has been made), pays the whole debt to *E*. Is *B* allowed to do that, and is the solidary obligation extinguished?

ANS.: Yes, for after all no demand had been made by *C* upon *B*. It is only *A* that is bound, not *B*. (See 8 *Manresa* 210).

Art. 1215. Novation, compensation, confusion or remission of the debt, made by any of the solidary creditors or with any of the solidary debtors, shall extinguish the obligation, without prejudice to the provision of Article 1219.

The creditor who may have executed any of these acts, as well as he who collects the debt, shall be liable to the others for the share in the obligation corresponding to them.

COMMENT:

(1) Effect of Novation

Novation is the modification of an obligation by changing its object or principal conditions, or by substituting the person of the debtor, or by subrogating the person of the debtor, or by subrogating a third person in the rights of creditor. (Art. 1291, *Civil Code*).

(a) Example:

A and *B* are solidarily liable to *X* and *Y*, solidary creditors, for the payment of P800,000. *A* and *X* agreed that instead of paying P800,000, *A* will just paint *X*'s house (including costs of the points to be used). Here the solidary obligation of paying P800,000 is *extinguished* but a new one, that of painting *X*'s house, has arisen. If *B* did not consent to the novation, *B* will not be bound to *X* and *Y* in any way, and moreover, will not be obliged to give *A* anything except insofar as he (*B*) has been benefited. Upon the other hand,

only *X* will be allowed to prejudice his co-creditor *Y*, so *X* must reimburse *Y* for P400,000 (which is really *Y*'s share of the credit). (*Art. 1215, 2nd par.*).

- (b) *A* and *B* are solidary debtors of *X*. If *A* is granted an *extension of time* within which to pay, is *B* released from the obligation?

ANS.: No. (*See Phil. Guaranty v. Jose, O.G. Aug. 16, 1941, p. 1475*). The only effect is this: if *X* sues *B*, *B* will pay the whole debt *minus* the share of *A*. When the extended period terminates, *X* can demand the remaining balance (*A*'s share) from either *A* or *B*. And if *B* pays again, *B* will now have the right to collect reimbursement from *A*, for *A*'s share. (*See Inchausti and Co. v. Yulo, 34 Phil. 978*).

[NOTE: The rule is different in suretyship, where although the surety is also, in a way, a solidary debtor, an extension of time to the principal debtor without the surety's consent will *release* the surety from the contract. (*See Phil. Nat. Bank v. Veraguth, 50 Phil. 253*).]

(2) Effect of Compensation

Compensation is that which takes place when two persons, in their own right, are creditors and debtors of each other. (*Art. 1278, Civil Code*) — (as when *A* owes *B* P1,000,000 and *B* owes *A* P1,000,000). Compensation may be *total* or *partial*, depending upon the amount involved. Total compensation of course automatically extinguishes the obligation, whether known or unknown to the parties. (*See Art. 1290, Civil Code*).

- (a) *Example of Total Compensation in Connection with Solidary Obligation:*

A and *B* are solidary debtors of *X* and *Y*, solidary creditors to the amount of P400,000. But *X* owes *A* P400,000 on account of a different obligation. Here we have a case of *automatic extinguishment* of the obligation by virtue of total compensation. But *B* should not benefit completely since it was *A*'s credit that was used to compensate. So *B* owes *A* P200,000 (his share of the debt). Upon the other hand, *Y* should not be prejudiced, so *Y* can recover P200,000 (his credit) from *X*. (*Art. 1215, par. 2*).

- (b) *Example of Partial Compensation in Connection with Solidary Obligations:*

A and B are solidary debtors of C to the amount of P2,000,000, but C is indebted to A for P500,000. This is a case of *partial* compensation, and therefore the solidary obligation amounting to P1,500,000 still subsists.

(3) Effect of Confusion (or Merger)

Confusion or merger is that which takes place when the characters of creditor and debtor are merged in the same person (*Art. 1275, Civil Code*), as when my check in the course of negotiation, is eventually endorsed to me.

Example:

A and B made a negotiable promissory note in favor of C and D, whereby A and B bound themselves solidarily to C and D, solidary creditors. C and D endorsed the note in favor of E; E in favor of F; F in favor of A. Notice that A, *who is a debtor*, now becomes a creditor. There is merger or confusion of rights here; the solidary obligation is extinguished; but B is indebted to A for his (B's) share of the debt.

(4) Effect of Remission (or Waiver)

Remission or waiver is that act of liberality whereby a creditor *condones* the obligation of the debtor; that where the creditor tells the debtor to "forget about the whole thing." (*See Art. 1270, Civil Code*). (*Remission may be total or partial*).

- (a) *Example of Total Remission:*

A and B are *solidary* debtors of X and Y, solidary creditors to the amount of P4 million. X tells A that he was waiving the whole obligation. Here, the total remission completely extinguishes the whole obligation, without prejudice to Y collecting from X his (Y's) share of the credit of P2 million, otherwise X's remission would prejudice Y. Upon the other hand, B does not have to reimburse A for anything, *for after all* the remission was a gratuitous act, and A did not have to give anything to the creditors. (*See 8 Manresa, pp. 225-226*).

(b) *Example of Partial Remission:*

A, B, and C are solidary debtors of X in the amount of P3 million. X then made a demand from A but collected only P2 million because he (X) was remitting A's share (of P1 million). How much can A recover from B and C?

ANS.: Only P1 million from each because the solidary debt of P3 million had been reduced by partial remission to only P2 million.

[NOTE: It follows, in the example given, that A can be reimbursed the whole P2 million (plus interest in the proper case), and therefore it is as if A did not have to pay from his own pocket. This is *but just* because after all, A's share had been remitted. This example is also a correct illustration of the rule that a partial remission benefits ALL in that the solidary debt is *diminished*, so that if A had not been able to pay, or had the creditor chosen to collect from either B or C, he can demand not P3 million but only P2 million. (See *Inchausti & Co. v. Yulo*, 34 Phil. 978).]

(NOTE: Although from said viewpoint all had been benefited, it should be noted that the individual shares of B and C have NOT really been diminished.)

(NOTE: Under Art. 1219, if the share of a solidary debtor is *remitted* by the creditor after another solidary debtor had paid the *whole* obligation, the remission is useless because there was really nothing more the creditor could remit in view of the *complete* payment. In such a case, the debtor whose share was remitted can still be made to reimburse his share to the payor-debtor. *Inferentially*, had remission preceded payment, the debtor whose share has been remitted cannot be made to reimburse anything, for after all, the payor-debtor will have paid only the *balance* of the debt (after deducting the share of the debtors who has received the benefit of the remission).

Art. 1216. The creditor may proceed against any one of the solidary debtors or some or all of them simultaneously. The demand made against one of them shall not be an obstacle to those which may subsequently be directed against the others, so long as the debt has not been fully collected.

COMMENT:**(1) Against Whom Creditor May Proceed**

Against *any, some, or all* of the solidary debtors — *simultaneously*.

Constante Amor de Castro v. CA
GR 11838, Jul. 18, 2002

When the law expressly provides for solidarity of the obligation, as in the liability of co-principals in a contract of agency, each obligor may be compelled to pay the entire obligation. The agent may recover the whole compensation from any one of the co-principals in a contract of agency, each obligor may be compelled to pay the entire obligation. The agent may recover the whole compensation from any one of the co-principals, as in this case.

Indeed Art. 1216 of the Civil Code provides that a creditor may sue any of the solidary debtors. Solidarity does not make a solidary obligor an indispensable party in a suit filed by the creditor. Art. 1216 says that the creditor may proceed against anyone of the solidary debtors or some or all of them simultaneously.

(2) Effect of Not Proceeding Against All

If the creditor sues only one, or two, or several of the debtors (but not all) there is no waiver against those not yet sued. They may be proceeded against later. (*See Art. 1216; see also Guerrero v. Court of Appeals, L-22366, Oct. 30, 1969*).

(3) Applicability of Art. 1216

Note that Art. 1216 applies only to *solidary* obligations, *not to joint* ones, for in the latter, failure to collect from one joint debtor his share does not authorize the creditor to proceed against the others, regarding the insolvent debtor's share. (*See Luna v. Arcenas, 34 Phil. 80*).

Phil. National Bank v. Concepcion Mining Co., et al.
L-16968, Jul. 31, 1962

FACTS: In a solidary obligation evidenced by a promissory note, the solidary debtors were the Concepcion Mining Co.,

Vicente L. Legarda, and Jose S. Sarte. Legarda was not sued, however, because he had died before the suit began. The other debtors then asked that the *estate* of Legarda be included as a party-defendant.

HELD: The estate of Legarda does not have to be sued since under Art. 1216, the creditor or payee of the promissory note may sue ANY of the solidary debtors.

Phil. National Bank v. Nuevas
L-21255, Nov. 29, 1965

Art. 1216 applies even if the suit is for the revival of a judgment. Hence, if in the judgment, all the debtors were declared “jointly and severally liable,” the *entire* judgment may be enforced against ANY of them.

Operators Incorporated v. American Biscuit Co., Inc.
GR 34767, Oct. 23, 1987

Even if the solidary nature of the debtor’s liability is self-evident, the creditor cannot disregard an arbitration clause stipulated in the contracts. Solidarity does not make a solidary obligor an indispensable party in a suit filed by the creditor.

(4) Passive Solidarity

Art. 1216 applies to what is called *passive solidarity* (solidarity among the debtors). It can also apply to *mixed* solidarity.

(5) Passive Solidarity and Suretyship

(a) *Similarities*

- 1) Both the solidary debtor and the surety guarantee for *another* person.
- 2) Both can demand reimbursement.

(b) *Differences*

- 1) The solidary debtor is indebted for his own share only; the surety is indebted only for the share of the principal debtor.

- 2) Hence, the solidary debtor can be reimbursed what he has paid MINUS his own share; the surety can be reimbursed for everything he paid.
- 3) If a solidary debtor receives an extension of the period for payment, the others are still *liable* for the whole obligation now, *minus* the share of the debtor who has received the extension (but same share can be demandable also from them upon the arrival of the extended term). If a principal debtor receives an extension, without the surety's consent, the surety is released. (See *Phil. Guaranty v. Jose, O.G., Aug. 16, 1941, p. 1475* and *Stevenson v. Climaco, 36 O.G. 1571*).

(6) Examples

- (a) A and B are solidary debtors of C to the amount of P1,000,000. Either A or B may be made to pay the whole P1,000,000 but the payer can collect half (P500,000) from the other (since each is a principal debtor).
- (b) A borrowed from C P1,000,000. B acted as surety (solidary guarantor) for A. C can demand P1,000,000 from either A or B. But if B is made to pay, B can demand the whole P1,000,000 from A since B is not really a principal debtor.

[NOTE: A guarantor binds himself subsidiarily to answer for the principal debtor, in case of insolvency; hence, the creditor *cannot* immediately proceed against the guarantor; a surety is a guarantor who binds *himself solidarily* with the principal debtor, hence, creditor can proceed against the surety immediately (that is, without first exhausting the properties of the principal debtor). (See Art. 2047, Civil Code).]

(7) Problems

- (a) A and B are solidary debtors of X and Y to the amount of P4 million. X sued A but recovered only P3.5 million. May Y still sue B for P500,000?

ANS.: Yes, because the debt has *not yet* been entirely satisfied.

- (b) *A* and *B* are solidary debtors of *X* and *Y*. *X* sues *A* but *A* wins the case (for example, on the ground that the subject matter is illegal). Can *Y* still sue *B*?

ANS.: No more because here the principle of *res judicata* clearly applies. Since *X* was representing *Y*, there would be identity of parties.

Art. 1217. Payment made by one of the solidary debtors extinguishes the obligation. If two or more solidary debtors offer to pay, the creditor may choose which offer to accept.

He who made the payment may claim from his co-debtors only the share which corresponds to each, with the interests for the payment already made. If the payment is made before the debt is due, no interest for the intervening period may be demanded.

When one of the solidary debtors cannot, because of his insolvency, reimburse his share to the debtor paying the obligation, such share shall be borne by all his co-debtors, in proportion to the debt of each.

COMMENT:

(1) Effects of Payment

The Article gives the effects of payment.

(2) ‘Payment’ Defined

Payment is one of the ways by which an obligation is extinguished and consists in the delivery of the thing or the rendition of the service which is the object of the obligation.

(3) Problems

- (a) If a solidary debtor pays the creditor, what happens to the obligation?

ANS.: The obligation is extinguished. “Payment made by one of the solidary debtors extinguishes the obligation.” (*1st sentence, Art. 1217, Civil Code*).

- (b) *A, B, and C are the solidary debtors of D. A and B offer to pay. Is the creditor allowed to choose which offer to accept?*

ANS.: Yes. "If two or more solidary debtors offer to pay, the creditor may choose which to accept." (Art. 1217, 2nd sentence, Civil Code).

- (c) *Suppose in problem (b), although A and B have offered to pay, D nevertheless makes a demand upon C, is D allowed to do so?*

ANS.: Even if C has not offered to pay, it is believed that D would be allowed to make a demand upon C. "The creditor may proceed against any one of the solidary debtors." (1st sentence, Art. 1216, Civil Code). But, of course, it would be a foolish creditor who would refuse to accept payment from one who offers it.

- (d) *A, B, C, and D are solidary debtors of E to the amount of P1.2 million. A pays E the whole P1.2 million. Is A entitled to reimbursement from B, C, and D?*

ANS.: Yes, reimbursement plus interest from the date of payment.

(4) Nature of Liability for Reimbursement

A, B, C, and D are solidary debtors of E to the amount of P1.2 million. A paid E the whole amount of P1.2 million. It is clear that A is entitled to reimbursement for now A has become the creditor for reimbursement. Are B, C, and D considered the solidary debtors of A?

ANS.: No. With reference to the reimbursement B, C, and D are not solidary debtors of A but merely joint debtors of A. It is true that B, C, and D, together with A, used to be solidary debtors of E, but A's payment to E of the whole amount has extinguished that solidary obligation, and what remains now is merely the joint obligation of reimbursement. As a matter of fact, the law provides that: "He who made the payment may claim from his co-debtors only the share which corresponds to each, with the interest for payment already made." (1st sentence, second paragraph, Art. 1217, Civil Code). This clearly shows that the

solidary obligation which has been extinguished has now been converted into a *joint* obligation for reimbursement; otherwise, the law would not have provided that what the paying debtors can recover is *only* the *proportionate* share, with interest.

Since originally there were four debtors, each has a proportional share of P300,000 in the obligation. Hence, *A* can recover P300,000 with interest from each of the other three.

It should be noted, however, that the liability is *not* the ordinary joint one, for in the instant case, the *insolvency* of one must in the meantime be shouldered by the rest. (*Last paragraph, Art. 1217, Civil Code*).

Inchausti & Co. v. Yulo
34 Phil. 978

FACTS: *A, B, C, D, E, and F* were solidary debtors of *G* to the amount of P253,445.42. Later in an agreement with *B, C, D, E, and F*, the debt was reduced by *G* to P225,000. *G* sued *A*. Because of the partial remission, *A* was made to pay only P225,000. *Issue:* How much can *A* recover from the other solidary debtors?

HELD: *A* can recover the proportional shares of the other, not with respect to P253,445.42 but with respect to P225,000, the amount as reduced. Since there are 6 solidary debtors, he can recover 1/6 of P225,000 from each plus interest from the time of payment.

(5) Basis of the Right to be Reimbursed

The fact of payment (and not the original contract) is the basis of the right to be reimbursed, for not until then had he the right to be reimbursed. Hence, the obligation of the others to reimburse him arises only from the time payment is made. (*Wilson v. Berkenkotter, GR L-4476, Apr. 20, 1953*).

Wilson v. Berkenkotter
92 Phil. 918

FACTS: In 1938, three persons *A, B, and C* signed as solidary debtors a promissory note in favor of the Chartered Bank

of India in the amount of P90,000. In 1944, during the Japanese occupation, *B* paid the whole amount in Japanese notes. In 1950 (after liberation), *A* offered to pay *B* his (*A*'s) share in the obligation. The issue is whether P30,000 or only P600 (the equivalent of P30,000 under the Ballantyne scale) must be reimbursed, considering that payment by *B* to the bank was in Japanese money.

HELD: It has been held in several cases that a debt contracted during the Japanese occupation, and payable on demand or during the occupation (but not after the war or at a specified date thereafter as to indicate that the parties were speculating on the ending or continuation of the war) would be paid under the Ballantyne scale. In this case, therefore, we have to find out *when* the obligation of *A* to *B* was created, whether it was before the war or during the war. If during the war, then the Ballantyne scale should be sufficient. And our decision is that in this case, the obligation to reimburse was made only during the war since before payment by *B*, *A* was not yet *B*'s debtor. Hence, the correct sum is P600.

(6) Substitution of Parties

A, *B*, and *C* are solidary debtors of *X* who sued all of them. If during the pendency of the case, *A* pays *X*, in the same action *A* can be changed from defendant to plaintiff in substitution of *X*. This is to enable *A* to collect reimbursement of contribution from *B* and *C*. (See *Bank of the Phil. Islands v. McCoy*, 52 Phil. 831).

(7) BAR

A, *B*, and *C* executed jointly and severally a promissory note for P300,000 in favor of *D* payable after 6 months. Upon maturity, *A* and *B* refused to pay. Is *D* entitled to recover from *C* the P300,000? In case of payment by *C*, what right, if any, has he against *A* and *B*?

ANS.: Yes, *D* can get the whole P300,000 from *C*, because *C* bound himself *in solidum*. If *C* pays the whole amount, *B* and *A* will each be liable to him for P100,000. (See Arts. 1216 and 1217, Civil Code).

(8) PROBLEM

A and B were sued on a promissory note which read as follows: "Manila, May 1, 2004. For value received, we, the undersigned, promise solidarily to pay C or his order, on or before May 1, 2005, the sum of P1,000,000, plus an interest of 6% (Sgd.) A and B." Should B turn out to be insolvent, may C recover all his claim from A who is solvent? Why?

ANS.: Yes, because A had bound himself solidarily, without prejudice, of course, to his recovering later on from B, the share of B in the debt, plus interest from the date of payment. (Art. 1217, *Civil Code*).

(9) ANOTHER PROBLEM

A, B, and C are joint and several debtors of D. D allows C an extension of two years within which to pay *his portion* of the indebtedness. Upon being sued by D, may A and B interpose the defense of the extension of the time granted to C? Should A and B eventually pay the entire obligation, may they compel C to reimburse them with his share *without waiting* for the two-year extension granted to D? Reasons.

ANS.: Yes, A and B can set up the extension but only as partial defense, limited to C's share. Hence, they should now pay ALL minus C's share. (See *Inchausti v. Yulo*, 34 Phil. 978). If they paid ALL (without deductions) they *must wait* for the 2-year period before they can compel reimbursement from C. This is because A and B merely stepped into the shoes of the creditor D, and therefore C can plead against them the defense of extension of payment.

Art. 1218. Payment by a solidary debtor shall not entitle him to reimbursement from his co-debtors if such payment is made after the obligation has prescribed or become illegal.

COMMENT:**(1) Effect of Payment of Prescribed Debt**

A and B are solidary debtors of C to the amount of P1,000,000.

The debt prescribed. But *A voluntarily* paid *C*, nevertheless, because *A* felt morally obliged to so pay.

- (a) May *A* recover from *C* what he has paid?
- (b) May *A* get any reimbursement from *B*?

ANS.:

- (a) *A* cannot recover from *C* what he has paid because it was voluntarily given after *A* knew of the prescription of the debt. The law says, “when a right to sue upon a civil obligation has lapsed by extinctive prescription, the obligor cannot recover what he has delivered or the value of the service he has rendered.” (*Art. 1424, Civil Code*). (*NOTE: If payment had been made by A to C, without A knowing that the debt had prescribed, A can recover from C on the basis of solutio indebiti.*)
- (b) *A* cannot get any reimbursement from *B* because *A* paid the debt after it had prescribed. The law says, “Payment by a solidary debtor shall not entitle him to reimbursement from his co-debtors if such payment is made after the obligation has prescribed or become illegal.” (*Art. 1218, Civil Code*).

(2) Effect of Payment of an Illegal Obligation

A and *B* are solidarily bound to give *C* some drugs worth P1,000,000. Later, the law prohibits the transaction of said drugs, and declares the drugs to be outside the commerce of man. Knowing this, *A* nevertheless delivers the drugs to *C*. May *A* now get reimbursement from *B*?

ANS.: No, *A* cannot get any reimbursement from *B* because *A* made the payment after the obligation had become illegal.

Art. 1219. The remission made by the creditor of the share which affects one of the solidary debtors does not release the latter from his responsibility towards the co-debtors, in case the debt had been totally paid by anyone of them before the remission was effected.

COMMENT:**(1) Effect of Remission Made After Total Payment Had Already Extinguished the Obligation**

This Article is designed to prevent fraud and to give justice to the paying debtor. (*See 8 Manresa 226*). *Example: A and B solidarily owe X P1,000,000. A paid X the whole amount. Later, X remitted B's share. Can A still recover reimbursement of P500,000 from B?*

ANS.: Yes.

(2) Reason for the Provision

Since payment extinguishes the obligation, there is nothing more to remit. (*See Comments under Art. 1215, Civil Code*).

(3) Problems

- (a) *A, B, and C solidarily owe X P3 million. X remitted C's share. A, therefore, paid later only P2 million. Can A recover reimbursement?*

ANS.: Yes, but only from *B* and not from *C*, whose share had previously been remitted. Here, remission was previous to the payment.

- (b) In problem (a), how much can *A* recover from *B* and *C*?

ANS.: From *B*, P1 million with interest. From *C*, nothing, because *C*'s share had been remitted.

- (c) In problem (b), suppose *B* is insolvent, can *C* be made liable in the meantime for part of the insolvency? In other words, can *A* get anything from *C*, whose share the creditor had remitted?

ANS.: Yes, because under Art. 1217, "when one of the solidary debtors cannot, because of his *insolvency*, reimburse his share to the debtor paying the obligation, such share must be borne by all his co-debtors in proportion to the debt of each." In other words, even if *C*'s share has been remitted (and even if he therefore does not have to reimburse for his *own* share) he will still have to bear part

of the burden of *B*'s insolvency, because the creditor's act of liberality towards him cannot excuse him from fulfilling his legal duty under the provision hereinabove mentioned. Thus, *B*'s share of P1 million will be borne in the meantime by *A* and *C*, and *C* will have to give P500,000 to *A*. Later, *C* can recover from *B*, should the latter's finances improve.

Art. 1220. The remission of the whole obligation, obtained by one of the solidary debtors, does not entitle him to reimbursement from his co-debtors.

COMMENT:

(1) Remission of the Whole Obligation

This Article is a new provision of the Civil Code. Remission, it must be borne in mind, is essentially gratuitous. Note that this Article applies only when the whole obligation is remitted.

(2) Example

A and *B* are solidary debtors of *C* to the amount of P1,000,000. *C* remitted the whole obligation when *A* offered to pay. *A* here cannot get any reimbursement from *B* since after all, *A* did not pay anything to *C*. To allow the contrary would be to induce fraud and to countenance partiality.

Art. 1221. If the thing has been lost or if the prestation has become impossible without the fault of the solidary debtors, the obligation shall be extinguished.

If there was fault on the part of any one of them, all shall be responsible to the creditor for the price and the payment of damages and interest, without prejudice to their action against the guilty or negligent debtor.

If through a fortuitous event, the thing is lost or the performance has become impossible after one of the solidary debtors has incurred in delay through the judicial or extra-judicial demand upon him by the creditor, the provisions of the preceding paragraph shall apply.

COMMENT:**(1) Effect of Loss or Impossibility**

- (a) If without fault — no liability.
- (b) If with fault — there is liability (also for damages and interest).
- (c) Loss because of a fortuitous event AFTER default — here, there will be liability because of the DEFAULT.

(2) Problems

- (a) *A* and *B* are solidarily obliged to give *C* this particular car. The car was lost by a fortuitous event, and without any fault on the part of the debtors. What happens to the obligation?

ANS.: The obligation is extinguished. It is essential here, however, that the debtors be not guilty of default.

- (b) If in problem (a), the car was lost through the fault of *A*, and *C* makes a demand later upon *B*, should *B* be liable for the price of the car as well as damages or interest?

ANS.: Yes, *B* will still be liable even if he was not at fault at all. Remember that a solidary obligation implies mutual agency and mutual confidence. The law expressly makes *B* liable in such a case both for the price of the car as well as damages or interests, but *B* can later on recover from *A* the whole of what he paid, for had *A* not been at fault, the obligation would have been already extinguished.

- (c) *A*, *B*, and *C* are solidary debtors of *D* in an obligation to give a particular car. *D* makes an extrajudicial demand upon *A*. After the demand, the car was lost by a fortuitous event. Is the obligation extinguished? If not, what is *D*'s right?

ANS.: The obligation is not extinguished because the loss through a fortuitous event occurred after default on the part of the debtors had arisen. *D*'s right is to exact the price of the car from any of them. The debtors, however, who did not have a hand in the default (*B* and *C*) have the

right to recover from their co-debtor, A, who after all, was responsible due to his default.

Art. 1222. A solidary debtor may, in actions filed by the creditor, avail himself of all defenses which are derived from the nature of the obligation and of those which are personal to him, or pertain to his own share. With respect to those which personally belong to the others, he may avail himself thereof only as regards that part of the debt for which the latter are responsible.

COMMENT:

(1) Defenses in Actions Filed

This Article applies in ACTIONS filed by the creditor.

(2) Kinds of Defenses

- (a) Those derived from the *nature* of the obligation (this is a *complete* defense).

Examples:

- 1) lack of consideration or cause
- 2) absolute simulation (as when the contract is totally fictitious)
- 3) illegal consideration
- 4) extinguishment of the obligation (as when the whole debt has been *paid, remitted, or has prescribed*)
- 5) non-fulfillment of the suspensive condition (if made upon the whole object or upon *all* the debtors)
- 6) Statute of Frauds
- 7) when ALL the debtors were incapacitated to give consent (such as unemancipated minors, insane, idiots, persons under a hypnotic spell)
- 8) when there are VICES OF CONSENT (vitiated consent) on the part of ALL the debtors (such as when *all* were forced or intimidated or unduly influenced or were led into error)

- (b) Those *personal* to the debtor sued. (This is a *complete* defense *generally*, but if the defense is non-fulfillment yet of a *condition* or the non-arrival yet of the term, this is only a PARTIAL defense, that is, he will still be liable except for his own share in the meantime). (See *Inchausti v. Yulo*, 34 Phil. 987).

Examples:

- 1) Vitiating consent (as when he was *forced*, etc.) — COMPLETE defense.
 - 2) Incapacity to give consent (as when he is a *minor*) — COMPLETE defense.
 - 3) Non-fulfillment of condition imposed regarding his share (PARTIAL defense, unless provided otherwise).
 - 4) Non-arrival of term (regarding his share — PARTIAL defense — unless provided otherwise).
- (c) Those *personal* to the *others* — *same as (b)* — (*Partial* defense regarding share of others involved).

(3) Examples

- (a) A, B, and C are solidarily indebted to X for the selling of shabu or the sale of property of public dominion. If A, B, or C is sued, none can be held liable. This is a complete defense.
- (b) A, B, and C are solidarily indebted to X for P3 million but A's consent had been obtained by intimidation.

- 1) If X sues A, how much will A be liable for?

ANS.: Nothing, for as to him, this is a *complete* defense. After all, he would not have been involved at all, had there been no intimidation.

- 2) If X sues B, how much will B be liable for?

ANS.: For the whole P3 million MINUS A's share (P1 million) if B puts up A's vitiating consent as a defense. Having only a PARTIAL defense, B can still be held liable for P2 million.

PROBLEM

On Jun. 15, 2005, X, Y, and Z executed a promissory note promising to pay B the sum of P3,000,000 jointly and severally with interest of 10% *per annum* within 6 months. In an action by B against X for nonpayment of the note, X interposed the defenses (1) that Y was a minor when the note was executed, and (2) that B had given an extension of one year to Z. What are the effects of these defenses?

ANS.: B can recover P1,000,000 because Y's minority is a partial defense for X (for Y's share of P1,000,000). The extension to Z is also a *partial* defense for X (for Z's share of P1,000,000). (*Art. 1222; see Inchausti v. Yulo, 34 Phil. 978*).

Braganza v. Villa Abrille
L-12471, Apr. 13, 1957

FACTS: On Oct. 20, 1944, Rosario de Braganza and her two minor sons (18 and 16 years of age) borrowed from Villa Abrille P70,000 in Japanese money, promising to pay *solidarily* P10,000 in legal currency of the Philippines 2 years after the war. The money was used for the support of the children. For failure to pay, Villa Abrille sued in March 1949. The mother and the two sons pleaded in defense the *minority* of the two children at the time the contract was entered into.

HELD:

- 1) The mother is liable for 1/3 of the P10,000. *Reason:* The minority of her children did not completely release her from liability, since minority is a *personal* defense of the minors. She can avail herself of said defense only as regards that part of the debt for which the minors are liable.
- 2) The contract entered into by the minors is *voidable*, but since it cannot be denied that they had profited by the money they received (for their support), it is fair to hold them liable to the *extent* of said benefit (computed in accordance with the Ballantyne scale).

**Ouano Arrastre Service, Inc. v.
Aleonor, et al.
GR 97664, Oct. 10, 1991**

FACTS: International Pharmaceuticals, Inc. (IPI) sued the Mercantile Insurance Company and Ouano Arrastre Service, Inc., for replacement of certain equipment imported by IPI which were insured by Mercantile but were lost on arrival, allegedly because of mishandling by Ouano. Ouano's answer was filed by the law firm of Ledesma, *et al.* and signed by Atty. Manuel Trinidad of the Cebu branch of the law office. However, Atty. Trinidad later resigned from the law firm and Atty. Fidel Manalo, a partner from the Makati Office filed a motion to postpone the hearing, stating that the case had just been endorsed to him by Ouano.

On Jan. 12, 1990, after the trial which Atty. Manalo handled for Ouano, the trial court held Mercantile and Ouano jointly and severally liable for the cost of replacement of the damaged equipment plus damages. Only Mercantile appealed. On Jun. 19, 1990, IPI moved for execution of the decision against Ouano which the judge granted on Jun. 25, 1990. On Jun. 26, 1990, Ouano's counsel Atty. Catipay filed a notice of appeal claiming that the decision was "mistakenly sent" by the trial court to the law firm's head office in Makati. The trial judge denied Ouano's motion, declaring that the appeal cannot be given due course for lack of merit. The Court of Appeals (CA) dismissed Ouano's appeal. Petitioner complains that an immediate execution, pending Mercantile's appeal, would result in "complexities" if the (CA) were to absolve Mercantile of its liabilities, that Ouano would have no recourse against its solidary co-debtor and would in effect be held the only one liable under the trial court's judgment.

HELD: If that were to happen, Ouano has only itself to blame. It allowed the period for appeal to lapse without appealing. Petitioner also argues that under the Civil Code, a solidary co-debtor can raise the defenses personal to his co-debtor and that, therefore, Ouano should be exempt from paying the portion of the judgment corresponding to Mercantile. The Supreme Court had rejected a similar claim made to delay execution of a trial court's decision. Moreover, Ouano argues that defenses personal to co-debtors are available to the other co-debtor because "the rights and liabilities of the parties are so interwoven

and dependent on each other, as to be inseparable,” *i.e.*, the rights and liabilities to be “interwoven” in their defenses must be “similar.” Ouano’s and Mercantile’s defenses actually conflict with each other. Ouano claims that the goods were received by it from the carrier vessel in bad condition. Mercantile, upon the other hand, maintains that the goods did not sustain any damage or loss during the voyage. Furthermore, Mercantile claims that, in any case, the insurance contract with IPI has already lapsed, a defense which Ouano, as the arrastre company responsible for the damage, cannot invoke to avoid liability. Finally, failing to appeal, Ouano effectively waived any right it might have had to assert, as against the judgment creditor, any defense pertaining to Mercantile. In other words, Ouano by its own act or inaction, is no longer in a position to benefit from the provisions of Art. 1222.

(4) Effect of Debtor’s Death

X is *Y*’s surety. Creditor sued *Y*, who died pending the proceedings. Although the credit must now be brought in the special settlement proceedings of *Y*’s estate, an *ordinary action* filed against *X* as surety would prosper, the transfer not being a defense of *X*. (*See Chinese Chamber of Commerce v. Pua Te Ching*, 16 Phil. 406).

Section 5

DIVISIBLE AND INDIVISIBLE OBLIGATIONS

Art. 1223. The divisibility or indivisibility of the things that are the object of obligations in which there is only one debtor and only one creditor does not alter or modify the provisions of Chapter 2 of this Title.

COMMENT:

(1) Divisible and Indivisible Obligations Defined

- (a) *Divisible obligation* — one capable of partial performance.

(*Example: to deliver 200 kilos of sugar*)

- (b) *Indivisible obligation* — one not capable of partial performance.

(*Example*: to deliver a specific car)

(2) ‘Indivisibility’ Distinguished from ‘Solidarity’

<i>SOLIDARITY</i>	<i>INDIVISIBILITY</i>
(1) refers to tie between the parties	(1) refers to nature of <i>obligation</i>
(2) needs at least two debtors or creditors	(2) may exist even if there is only one debtor and only one creditor
(3) the fault of one is the fault of the others.	(3) the fault of one is not the fault of the others.

(3) Classes or Kinds of Indivisibility

- (a) *conventional* indivisibility (by common agreement)
- (b) *natural or absolute* indivisibility (because of the nature of the object of undertaking — *Example*: to take a trip to Manila; or to give a particular ring)
- (c) *legal* indivisibility (if so provided for by law)

(4) Kinds of Division

- (a) *quantitative division* (depends on *quantity*: *Example* — if 10 chairs are equally divided between two brothers.)
- (b) *qualitative division* (depends on *quality*, irrespective of quantity. *Example*: If one child inherits land, and another inherits cash.)
- (c) *intellectual or moral division* (one that exists merely in the mind, and not in physical reality. *Example*: My brother and I own in common a car. My one-half share is only in the mind.)

Art. 1224. A joint indivisible obligation gives rise to indemnity for damages from the time anyone of the debtors does not comply with his undertaking. The debtors who may have been ready to fulfill their promises shall not contribute to the indemnity beyond the corresponding portion of the price of the thing or of the value of the service in which the obligation consists.

COMMENT:

(1) Joint Indivisible Obligation

- (a) Here the object is *indivisible* and yet the parties are merely bound *jointly*.
- (b) *Example:* Mila and Ligaya are jointly bound to give a *specific* car to Jose.

(2) Effect of Non-Compliance

- (a) The obligation is converted into a monetary one for indemnity.
- (b) *Example:* Mila and Ligaya promised jointly to give a specific car worth P2,400,000 to Jose. In the meantime, the car is with Honda Motors Co. Mila's share is, therefore, P1,200,000. If Mila, because of gambling, does not have the money, but Ligaya has P1,200,000 it is clear that they cannot get the car from Honda Motors Co. So they also cannot comply with their obligation of delivering the car to Jose. Here, the obligation to give the car is converted to a monetary obligation to give P2,400,000 to Jose. Ligaya is not responsible for Mila's insolvency, so she is duty bound to give only P1,200,000. Mila will be indebted to Jose for her share of P1,200,000.
- (c) Suppose in the preceding problem, the obligation was SOLIDARY and INDIVISIBLE, what would be the effect?

ANS.: Jose can demand the whole car or its price of P2,400,000 from Ligaya alone, but Ligaya can later recover reimbursement from Mila.

Art. 1225. For the purposes of the preceding articles, obligations to give definite things and those which are not susceptible of partial performance shall be deemed to be indivisible.

When the obligation has for its object the execution of a certain number of days of work, the accomplishment of work by metrical units, or analogous things which by their nature are susceptible of partial performance, it shall be divisible.

However, even though the object or service may be physically divisible, an obligation is indivisible if so provided by law or intended by the parties.

In obligations not to do, divisibility or indivisibility shall be determined by the character of the prestation in each particular case.

COMMENT:

(1) Obligations That Are Deemed Indivisible

- (a) Obligations to give definite things.
(Example: to give this car)
- (b) Those which are not susceptible of partial performance.
(Example: to conduct the orchestra in a single rendition of Buencamino's "Mayon Concerto")
- (c) Even if the thing is physically divisible, it may be indivisible if so provided by law.
- (d) Even if the thing is physically divisible, it may be indivisible if such was the intention of the parties concerned.

(2) Obligations That Are Deemed Divisible

- (a) When the object of the obligation is the execution of a certain number of days of work.
Example: When a laborer is hired to work for 10 days.
- (b) When the object of the obligation is the accomplishment of work by metrical units.

Example: When a laborer is hired to construct a street 3 meters wide and 50 meters long.

- (c) When the purpose of the obligation is to pay a certain amount in installments.

Example: When a debtor is required to pay in ten annual installments. (*Soriano v. Ubat*, L-11633, Jan. 31, 1961).

- (d) When the object of the obligation is the accomplishment of work susceptible of partial performance.

[NOTE: The character of the prestation or obligation will determine the divisibility or indivisibility of obligations not to do (negative obligations).]

(3) Effect of Illegality on a Divisible Contract

In case of a divisible contract, if the illegal terms can be separated from the legal ones, the latter may be enforced. (*Art. 1420, Civil Code; see Angel Jose Warehousing Co., Inc. v. Chelda Enterprises*, L-25704, Apr. 24, 1968).

(4) Cases

Blossom & Co. v. Manila Gas Corp. 55 Phil. 226

FACTS: *P* and *D* entered into a contract whereby *D* will supply *P* with gas tar at the price of P65 per ton. The contract was to run for 10 years, to start from the year 1919. *D* began delivering but later on he refused to continue. In 1923, *P* brought an action for damages against *D* and asked for damages. *P* was awarded damages up to 1923. The judgment became final, and *P* did not then ask for more. Later, *P* brought an action to recover damages from 1923 to 1929. *Issue:* Is he allowed to do so?

HELD: No, *P* is not allowed to recover any more damages. He should have questioned the judgment before it became final, but he did not. He had brought the first action to recover damages for the contract, the whole contract, and because the judgment in that case had already become final, it cannot be changed

although what he had obtained was only partial recovery. As a general rule, a contract to do several things at several times is divisible, and a judgment for a single breach of a continuing contract is not a bar to a suit for the subsequent breach.

“When the defendant (*D*) terminated a continuing contract by absolute refusal in bad faith to perform (absolute, because he refused not only a single delivery but all subsequent deliveries — Author’s comments), a claim for damages for a breach is an indivisible demand, and where as in this case, a former final judgment was rendered, it is a bar to any damages which the plaintiff may thereafter sustain.”

L. Buck & Son Lumber Co. v. Atlantic Lumber Co.
109 Federal 411

FACTS: A contract was made for the sale of a large quantity of logs to be delivered in monthly installments during a period of 8 years, payments to be made also in installment, at times having relations to the deliveries. It contained stipulations as to such payments, and guaranties as to the average size of the logs to be delivered in each installment. The seller terminated the contract for alleged breaches by the buyer and brought suit for damages, among them payments due for installments of the logs already delivered. The seller got some damages. Later, he wanted to recover for the other installments.

ISSUES:

- (a) Is this a divisible or indivisible obligation?
- (b) After recovery has been had of prior installments in a court action, may another court action prosper for the recovery of the remaining installments?

HELD:

- (a) “This is an indivisible contract, and not a number of separate and independent agreements for the sale of the quantity to be delivered and paid for each month, although there might be breaches of the minor stipulations and warranties with reference thereto which would warrant suits with a termination of the contract.”

- (b) The later court action for the recovery of the remaining installments cannot prosper. “The judgment in such action was conclusive as to all claims or demands of either party against the other, growing out of the indivisible contract.”

Section 6

OBLIGATIONS WITH A PENAL CLAUSE

Art. 1226. In obligations with a penal clause, the penalty shall substitute the indemnity for damages and the payment of interests in case of non-compliance, if there is no stipulation to the contrary. Nevertheless, damages shall be paid if the obligor refuses to pay the penalty or is guilty of fraud in the fulfillment of the obligation.

The penalty may be enforced only when it is demandable in accordance with the provisions of this Code.

COMMENT:

(1) ‘Penal Clause’ Defined

- (a) It is a *coercive means* to obtain from the debtor compliance from the debtor. (*Georg*).
- (b) A penal clause is an accessory undertaking to assume greater liability in case of breach. It is attached to obligations in order to insure their performance. (*8 Manresa 245*).

(2) Kinds of Penal Clauses

First classification:

- (a) *legal penal clause* — one that is imposed by the law
- (b) *conventional penal clause* — that which has been agreed upon by the parties

Second classification:

- (a) *subsidiary* — when only the penalty may be asked
- (b) *joint* — when both the principal contract and the penal clause can be enforced. (*8 Manresa 215*).

(3) Penal Clause Distinguished from a Condition

“Between a condition and a penalty, there are notable differences: the latter constitutes an obligation although accessory; the former does not. Therefore, the latter may become demandable in default of the unperformed principal obligation, and sometimes jointly with it, while the former or the condition is never demandable.” (*Manresa’s Commentaries on the Civil Code*, Vol. 8, p. 244).

(4) Principal Purpose of the Penal Clause

Its principal purpose is to insure the performance of an obligation and also to substitute for damages and the payment of interest in case of non-compliance. (*Art. 1224, 1st par., Civil Code*).

(5) Examples

- (a) A promised to construct the house of *B* within 80 days. In the contract, there is a provision to the effect that for every day’s *delay* after the stipulated 80 days, *A* would pay a fine or indemnity or penalty of P10,000. If the house is, therefore, constructed finally at the end of 85 days — 5 days more than the time stipulated — *A* would have to pay a penalty of P50,000, *i.e.*, whatever sum *B* agreed to give *A* for the construction of the house will be given to *A* minus, of course, the P50,000 imposed as penalty. The *first* purpose of the penal clause is, therefore, clear. Its insertion was to give *A* a motive to finish the construction on time; otherwise, he would have to suffer the penalty. The *second* purpose is also clear, namely, that instead of computing the actual damages that may have been caused by the five days’ delay, and instead of computing the legal rate of interest as damages, the matter has become simplified by the insertion of said penal clause, which in this case now assumes the part of liquidated damages. The general rule is, therefore, this: The penalty takes the place of indemnity for damages and the payment of interest.
- (b) A stipulation in the contract providing for the *compounding of interest* in case of non-performance partakes of the

nature of a penalty clause. If inequitable or unconscionable, the interest may be reduced. (*Hodges vs. Javellana*, L-17247, Apr. 28, 1962).

- (c) A stipulation in a contract for the sale of a residential lot that if within 2 years from the sale the buyer has not yet built 50% of his proposed residence, he would pay P11,123 to the seller — is an example of a penalty clause. (*Makati Development Corporation v. Empire Insurance Co.*, L-21780, Jun. 30, 1967).

(6) Exceptions to the General Rule that the Penalty Takes the Place of Indemnity for Damages and for the Payment of Interest (stated otherwise, Instances when ADDITIONAL damages may be recovered):

The exceptions are the following:

- (a) When there is express stipulation to the effect that damages or interest may still be recovered, despite the presence of the penalty clause;
- (b) When the debtor refuses to pay the penalty imposed in the obligation;
- (c) When the debtor is guilty of fraud or *dolo* in the fulfillment of the obligation. The reason for the third exception is clear: there can be no renunciation of an action to enforce liability for future fraud because, as we have seen, this is against public policy and against the express provisions of the law.

NOTE: Breach of the obligation WITHOUT fraud cannot constitute one of the exceptions. (*Cabarroguis, et al. v. Vicente*, L-14304, Mar. 23, 1960).

(7) May Any Penalty Be Demandable?

ANS.: No. The penalty may be enforced only when it is demandable in accordance with the provisions of the Civil Code, one of which states that the penalty may be reduced if it is inequitable or unconscionable. (*Art. 1229, Civil Code*).

(8) Cases**Navarro v. Mallari
45 Phil. 242**

FACTS: In a building contract, there was stipulation for a penalty clause. The builder, however, was sued for additional damages on account of breach of the contract. But the breach was not occasioned by fraud. *Issue:* Is the owner entitled to get more damages from the builder?

HELD: No, he cannot get damages other than what has been stipulated upon as the penalty or waiver of other damages, except if otherwise provided by law. A party to a building contract who is given the benefit of a stipulation fixing a round sum as liquidated damages for breach of contract on the part of the builder cannot be awarded additional damages at large for the same breach. Insistence upon receiving satisfaction of the penal clause operates as a renunciation of the right to other damages.

**Lambert v. Fox
26 Phil. 588**

FACTS: In the promissory notes executed by the defendants, and incorporated in the mortgage deeds, they voluntarily undertook to pay the sum of P1,300 as *court costs*, expenses of collection, and attorney's fees, *whether incurred or not*. *Issue:* Is this penal clause valid?

HELD: Yes, this stipulation is valid and permissible penal clause, not contrary to any law, morals, or public order, and is therefore, strictly binding upon the defendants. (*See Government of the Philippine Islands v. Lim*, 61 Phil. 737; *Bachrach v. Golvingco*, 39 Phil. 138; *Compania General de Tabacos v. Jalandoni*, 50 Phil. 501; *Bachrach Motor Co. v. Espiritu*, 52 Phil. 346; and *Manila Building & Loan Association v. Green*, 54 Phil. 507).

**Manila Racing Club, Inc. v. Manila Jockey Club
69 Phil. 55**

FACTS: A purchaser bought some property in installments. It was stipulated in the contract that failure to pay any subse-

quent installment would forfeit installments already made. In this case, the purchaser had already paid P100,000 but defaulted in the payment of the other installments. Is the clause in the contract regarding forfeiture valid?

HELD: Yes, such a clause is valid. It is in the nature of a penalty clause and is not iniquitous or unconscionable, considering that what has been forfeited amounts only to 8% of the stipulated price.

“The clause of the contract referring to the forfeiture of the P100,000 already paid, should the purchaser fail to pay the subsequent installments, is valid. It is in the nature of a penal clause which may be legally established by the parties. “In its double purpose of insuring compliance with the contract and of otherwise measuring before and the damages which may result from non-compliance, it is not contrary to law, morals, or public order because it was voluntarily and knowingly agreed upon by the parties. Viewing concretely the true effects thereof in the present case, the amount forfeited constitutes only 8% of the stipulated price, which is not excessive if considered as the profit would have been obtained had the contract been complied with. There is, moreover, evidence that the defendants had to reject another proposition to buy the same property. At any rate, the penal clause does away with the duty to prove the existence and measure of the damages caused by the breach.”

**Nakpil and Sons, et al. v. CA
GR 47851, Resolution on
Motion for Reconsideration**

FACTS: The promissory note signed by the borrower states that the loan of P42,050 shall bear interest at the rate of 19% *per annum*, and subject to penalty charges equivalent to 2% per month of any amount due and unpaid. This would yield an interest of P7,989.50 *per annum* or a total of P46,339.10 from November 22, 1978 to September 12, 1984, the date of filing the complaint.

HELD: Penalty interest of 1% a month or 12% *per annum* is reasonable so that from December 12, 1980 to September 12, 1984, penalty charges should be P19,202.83. Considering

that the borrowers have paid the amount of P68,676.75, they therefore owed the bank the amount of P38,915.18 when the complaint was filed. There is no indication in the records as to the fluctuation of actual interest rates from 1984 and, therefore, the Court orders interest at the legal rate of 12% *per annum* on the unpaid amount.

The imposition of 12% pursuant to Central Bank [Bangko Sentral] Circular 416 (passed pursuant to the authority granted to the Central Bank (Bangko Sentral) by Presidential Decree 116 which amended Act 2655, otherwise known as the Usury Law, is applicable only in the following: (1) loans; (2) forbearance of any money, goods or credit; and (3) rate allowed in judgments (judgments spoken of refer to judgments involving loans or forbearance of any money, goods or credits).

Country Bankers Insurance Corp. v. CA
GR 85161, Sep. 11, 1991

FACTS: Lessor Ventanilla and Lessee Sy, entered into a lease agreement over a theater. The lease was for six years. After more than two years of the operation of the theaters, Ventanilla made demands for the repossession of the leased properties in view of Sy's arrears in monthly rentals and non-payment of amusement taxes. In pursuance of their latter agreement, Sy's arrears in rental in the amount of P125,445 was reduced to P71,028. However, the accrued amusement tax liability of the three theaters to the City Government had accumulated to P84,000 despite the fact that Sy had been deducting the amount of P4,000 from his monthly rental with the obligation to remit the said deductions to the city government. Hence, letters of demand were sent to Sy demanding payment of the arrears in rentals and amusement tax delinquency. When Sy failed to pay the amounts in full, despite demands, Ventanilla padlocked the gates of the three theaters under lease and took possession thereof. Sy filed an action for reformation and injunction. By virtue of the injunction, Sy regained possession of the theater. The trial court held that Sy is not entitled to reformation. On the counterclaim, the court found that Ventanilla was deprived of the enjoyment of the leased premises and suffered damages as a result of the filing of the case by Sy and his violation of the

terms and conditions of the agreement. It held that Ventanilla is entitled to recover the damages in addition to the arrears in rentals and amusement tax delinquency of Sy and the accrued interest thereon. It found that as of the end of Nov. 1980, when Ventanilla regained possession of the three theaters, Sy's unpaid rentals and amusement tax liability amounted to P289,534. In addition, it held Sy under obligation to pay P10,000 every month from Feb. to Nov. 1980 or the total amount of P100,000 with interest on each amount of P10,000 from the time the same became due. Thus, P10,000 portion of the monthly lease rental was supposed to come from the remaining cash deposit of Sy but with the consequent forfeiture of the remaining cash deposit of P290,000, there was no more cash deposit from which said amount could be deducted further. It adjudged Sy to pay attorney's fees equivalent to 10% of the amounts above-mentioned.

Finally, the court held Sy thru the injunction bond liable to pay P10,000 every month from Feb. to Nov. 1980. The amount represents the supposed increase in rental from P50,000 to P60,000 in view of the offer of someone to lease the three theaters involved for P60,000 a month. The Court of Appeals (CA) sustained the trial court.

HELD: The Supreme Court affirmed the CA's decision and held that inasmuch as the forfeiture clause provides that the deposit shall be deemed forfeited, without prejudice to any other obligation still owing by the lessee to the lessor, the penalty cannot substitute for the P100,000 supposed damage resulting from the issuance of the injunction against the P29,000 remaining cash deposit. This supposed damage suffered by OVEC was the alleged P10,000 a month increase in rental (from P50,000 to P60,000), which OVEC failed to realize for ten months from Feb. to Nov. 1980 in the total sum of P100,000. This opportunity cost which was duly proven before the trial court, was correctly made chargeable by the said court against the injunction bond posted by CISCO. The undertaking assumed by CISCO under subject injunction refers to "all such damages as such party may sustain by reason of the injunction if the Court should finally decide that the Plaintiff was not entitled thereto." The CA correctly sustained the trial court in holding that the bond shall

and may answer only for damages which OVEC may suffer as a result of the injunction. The arrears in rental, the unremitted amounts of the amusement tax delinquency, the amount of P100,000 (P10,000 portions of each monthly rental which were not deducted from plaintiff's cash deposit from Feb. to Nov. 1980 after the forfeiture of said cash deposit on Feb. 11, 1980) and attorney's fees which were all charged against Sy were correct and considered by the CA as damages which OVEC sustained not as a result of the injunction.

(9) Obligations with a Penal Clause Distinguished from Examples from the Facultative and the Alternative Obligations

(a) *Obligations with a penal clause*

Example: Gloria is obliged to give me a diamond ring. If she fails to do so, she must give P700,000.

(NOTE: Ordinarily, Gloria cannot excuse herself from the duty of giving me the ring by simply paying P700,000. For her to substitute the penalty, she must be *expressly* given the right to do so.)

(b) *Facultative obligation*

Example: Gloria is obliged to give me a particular diamond ring. However, *if she so desires*, she may instead give me P700,000.

(NOTE: Here, Gloria is clearly and expressly allowed to make the substitution. If the ring is lost by a fortuitous event, she is *excused* from giving me the substitute of P700,000, for indeed the principal obligation has been extinguished.)

(c) *Alternative obligation*

Example: Gloria is obliged to give me *either* a particular diamond ring or P700,000.

(NOTE: Here, the choice given to Gloria is absolute. If, however, the ring is lost by a fortuitous event, she is *still* obliged to give me the P700,000.)

Art. 1227. The debtor cannot exempt himself from the performance of the obligation by paying the penalty, save in the case where this right has been expressly reserved for him. Neither can the creditor demand the fulfillment of the obligation and the satisfaction of the penalty at the same time, unless this right has been clearly granted him. However, if after the creditor has decided to require the fulfillment of the obligation, the performance thereof should become impossible without his fault, the penalty may be enforced.

COMMENT:

(1) Generally, Debtor Cannot Substitute Penalty for the Principal Obligation

The general rule is that the debtor is *not* allowed to just pay the penalty instead of fulfilling the obligation. He can only do so if the right has been EXPRESSLY reserved. The reason is that if he can just pay, fulfillment of the obligation will be considered an alternative one. The word EXPRESSLY means that any implied reservation is *not* allowed.

(2) Example

A promises to finish a certain piece of work within six months. The contract stipulates that in case he does not build the house at all, he is supposed to forfeit the sum of P1,000,000. In this case, as a general rule the contractor cannot just give the sum of P1,000,000 as a substitute for his non-performance of the obligation. It must be remembered that as a general rule, therefore, the penal clause is not supposed to substitute the performance of the principal obligation. He may, however, be expressly granted by the creditor the right to refrain from the execution of the contract by a forfeiture of the penalty.

**Cui v. Sun Chan
41 Phil. 523**

FACTS: A lessee rented property from a lessor. The contract of lease contained a stipulation to the effect that the lessee should not make any construction on the property without

the permission of the lessor, and that should the lessee do so without the permission of the lessor said improvements would inure to the benefit of the estate (lessor) and the lessee, in such a case, would not have any right to ask for any reimbursement for the cost of the construction. The lessee made some improvements without the consent of the lessor. Now, the lessor wants to evict the lessee for the violation of the conditions of the lease. The lessee, on the other hand, said that he should not be ousted because he was ready to forfeit the improvements in favor of the lessor's estate. *Issue*: Is the fact that the lessee is ready to forfeit the improvement on the estate sufficient to prevent his being ousted from the premises?

HELD: Even if the lessee is ready to forfeit the improvements on the estate, he may still be ousted from the premises for his having violated the condition imposed upon him, namely, not to make any such improvements without the permission of the lessor. It is true that the lessee was ready to fulfill what may perhaps be termed a penalty, but this does not excuse him from complying with the principal obligation of not making any improvements without the consent of the lessor. It must be borne in mind that a debtor (the lessee) cannot escape the fulfillment of the obligation by just paying the penalty, unless such right has expressly been granted him. Hence, everything considered, the lessee may lawfully be ousted from the premises.

(3) Generally, Creditor Cannot Demand Both Fulfillment and the Penalty at the Same Time

As a general rule, the creditor does *not* have this right to demand fulfillment of the obligation and the penalty at the same time. The exception arises when such a right has been CLEARLY granted to him.

[NOTE: In *Cabarroguis, et al. v. Vicente, L-14304, Mar. 23, 1960*, the Supreme Court held that in obligations for the payment of a sum of money, when a penalty is stipulated for default, BOTH the principal obligation *and* the penalty can be demanded by the creditor (*Government v. Lim, et al., 61 Phil. 737 and Luneta Motor Co. v. Mora, 73 Phil. 80*), with interest on the amount of the penalty from the date of demand, either judicial or extrajudicial.]

Vitug Dimatulac v. Coronel
40 Phil. 686

FACTS: A sold real property to B with the right of repurchase. It was agreed in the contract that should A who was occupying the property in the meantime as lessee default in the payment of rentals on the property, the right to redeem would be extinguished. The day came where there was such a default. B took possession of the property, claiming that her right as the new owner of the property had already been consolidated in herself because the seller did not have anymore the right to repurchase the property. She entered into a compromise with A regarding the past rentals. B now brings this action to recover the future rentals, meaning the rentals that should have accrued from the moment B took possession of the property until the time originally stipulated upon for the redemption of the property. *Issue:* Is B allowed to take over the property, thus consolidating the ownership in her, and at the same time ask for future rentals?

HELD: No. B is not allowed to have both remedies. The provision in the contract extinguishing the right of redemption upon the default of the payment of the rentals is in the nature of a penalty clause. According to the law, the general rule is that the creditor cannot demand both the performance of the principal obligation and the forfeiture of the penalty unless such right has been clearly granted to said creditor. In this case no such right was granted. It follows, therefore, that the creditor could not demand both specific performance and the forfeiture of the penalty. The action of the creditor B in taking possession of the property fully shows that she was eager to impose the penalty stipulated upon the contract. She, therefore, has no more right to insist on the payment of the future rentals. As a matter of fact, she had no right even to the past rentals, but evidently the debtor had already waived this by virtue of the compromise agreed upon between A and B as regard the past rentals.

Navarro v. Mallari
45 Phil. 242

FACTS: The defendant was obliged to construct a chapel for the plaintiff for P16,000. Of this amount, P12,000 has already

been paid and only P4,000 remains to be paid. The contract carried a penal clause to the effect that in case of non-compliance with the obligation, the defendant would have to pay a penalty of P4,000. It was proved at the trial that the defendant did not construct the chapel very well — did not construct it according to the specifications of the contract. Hence, Navarro brought this action to recover P4,000 from Mallari, the defendant, as penalty. On his part, Navarro refused to pay the balance of P4,000 which he still owed the defendant. In other words, the plaintiff Navarro wanted:

- (a) to get P4,000 from Mallari as penalty; and
- (b) not to pay anymore his (Navarro's) unpaid balance of P4,000.

ISSUE: Is Navarro lawfully entitled not to pay his remaining debt and at the same time ask for the penalty?

HELD: Navarro is really entitled to the penalty because of the poor construction of the chapel but since he still owes P4,000, what he can get compensates for what he still has to give. Hence, Navarro cannot really get anything. His debt compensates for his credit.

Art. 1228. Proof of actual damages suffered by the creditor is not necessary in order that the penalty may be demanded.

COMMENT:

(1) No Necessity of Proving Actual Damages

This Article is a new provision of the New Civil Code. The penalty may, in the proper case, be demanded without the necessity of proving actual damages.

(2) Reason

When a penal clause has been agreed upon in a contract, more as a punishment for the infraction thereof than a mere security, it is a lawful means for repairing losses and damages, and upon evidence of the violation of the conditions stipulated, the injured party is not obliged to prove losses and damages suf-

ferred, nor the extent of the same in order to demand the enforcement of the penal clause agreed upon. (*Palacios v. Municipality of Cavite*, 12 Phil. 140).

Lambert v. Fox
26 Phil. 588

FACTS: A was obliged under a contract with B, not to sell shares of stock for one year. A penal clause was provided. But A sold shares of stock within the period specified but damages were not proved by B to have been suffered by him (B). *Issue:* May B recover the penalty?

HELD: Yes, B may lawfully recover the penalty. “In this jurisdiction contracts are enforced as they are read, and parties who are competent to contract may make such agreements within the limitations of the law and public policy as they desire, and the courts will enforce them according to their terms. A penalty imposed for the breach of a contract not to sell shares of stock for one year will be enforced if the agreement is broken, no matter whether the person seeking to enforce the penalty has suffered damages or not.”

Art. 1229. The judge shall equitably reduce the penalty when the principal obligation has been partly or irregularly complied with by the debtor. Even if there has been no performance, the penalty may also be reduced by the courts if it is iniquitous or unconscionable.

COMMENT:

(1) When Penalty May Be Reduced by the Court

- (a) When the obligation has been partly complied with by the debtor. (*Partial Performance*) (See *Makati Development Corp. v. Empire Insurance Co.*, L-21780, Jun. 30, 1967).
- (b) When the obligation has been irregularly complied with by the debtor. (*Irregular Performance*).
- (c) When the penalty is iniquitous or unconscionable, even if there has been no performance at all. (*Unconscionable or Iniquitous*).

(2) Examples

- (a) A promises to deliver to B 100 bottles of wine on a certain day when a banquet will be held. The contract states that failure of A to do so on that day will result in a forfeiture of P100,000. On that day, A was able to deliver only 90 of the 100 bottles promised. It is unfair now for B to exact the payment of the full amount of 100 because here, there has been partial or irregular performance, and B has in some way been already benefited by the giving of the 90 bottles of wine.
- (b) The defendants were able to return only 5 of the 20 rifles taken by them by virtue of their licenses. The contract contained a penalty clause or a penal bond which was supposed to answer for *non-delivery*. Should the penal clause be reduced?

ANS.: Yes, the penal bond should be reduced or mitigated in view of the partial performance. (*Insular Gov't. v. Punzalan*, 7 Phil. 546).

- (c) Supposing in the above-mentioned problem, the defendants did not help at all in the recovery of the rifles, are they still entitled to a mitigation of the penal bond?

ANS.: Yes. When some of the lost arms are afterwards recovered, although the persons responsible for their safekeeping did not assist in their recovery, the liability under the bond shall be proportionately reduced. (*Insular Government v. Amechazurra, et al.*, 10 Phil. 637).

(3) Cases

Chua Gui Seng v. General Sales Supply Co., Inc.
91 Phil. 153

FACTS: Plaintiff leased to defendant his premises for a period of three years. It was also agreed that in addition, in order to guarantee performance, a deposit of P1,000 would be made, said P3,000 to be applied to the monthly rents of P500 for the *last six* months (that is, for the 1st 2 years and 6 months, P500 would be collected monthly; but for the remaining six

months, no more rent would be collected in view of the P3,000 already deposited). There was also a stipulation that in case of *non-completion* of the term of three years, the P3,000 would be forfeited. The tenant then faithfully paid for the first one and one-half years, but was *not* able to pay for 2 months. Plaintiff now wrote a letter to the defendant, asking:

- (a) that the terms of the contract be enforced, with the P3,000 being forfeited;
- (b) but stating that if the back rentals (for 2 months) would be paid within 15 days, the deposit of P3,000 would not be forfeited.

Upon receiving the letter of demand, the defendant *left* the premises without paying the 2 months rental, on the belief that this could be charged to the P3,000 deposit. *Issue*: Should the entire P3,000 be forfeited?

HELD: No, it is not proper that the entire P3,000 be forfeited for, after all, the lease had already existed for more than half of the period stipulated. Half of P3,000 may, however, be forfeited. It is unjust for the whole amount to be forfeited considering, aside from the *partial performance*, the following factors:

- (a) The landlord could look for another tenant after the 15-day period of grace.
- (b) The tenant did not leave in bad faith, for it honestly thought, from the letter of demand, that it was all right to leave, with the 2 months rent being merely deducted from the P3,000.

Yulo v. Pe
L-10061, Apr. 22, 1957

FACTS: A building was leased, with an advance payment of P6,000. It was provided in the contract that if the tenant defaults in the payment of the monthly rent, the contract will be automatically cancelled, and “at the same time, a right of *confiscation* is granted the lessor of the lessee’s advance payment as damages.” *Issue*: Is the stipulation valid?

HELD: The stipulation is a penalty clause, and even if iniquitous or unconscionable, in a sense, it is not void, but subject merely to equitable reduction. Moreover, the amount that can be recovered is not limited merely to actual or compensatory damages.

Umali v. Miclat
L-9262, Jul. 10, 1959

- (a) If the penalty clause is unreasonable, as when it provided for a surcharge of 10% every 30 days in case of failure to fulfill the obligation, equity demands that the same be REDUCED in fairness to the obligor. A surcharge of 20% *per annum* would, however, be reasonable.
- (b) If in addition to the surcharge as penalty, the contract *also provides* that damages may be recovered, said stipulation as to damages would be *all right*, and should be computed on the basis of 6% per annum, the obligation being monetary in character. Art. 1226 expressly allows a stipulation as to damages, in addition to the penalty.

Reyes v. Viuda y Hijos de Formoso
(C.A.) 46 O.G. No. 5621

A fortuitous event militates against the enforcement of a penalty clause against the *lessor* and against the *lessee*. For example, the dictatorial acts of the Japanese army in taking over a leased building during the Japanese occupation. From another viewpoint, if both parties committed a breach of a reciprocal obligation, it is clear that the penalty clause cannot be enforced.

[NOTE: It is thus clear that a penal clause cannot be enforced if:

- (a) the breach is the fault of the creditor (*TS, Dec. 19, 1891*);
- (b) or a fortuitous event intervened, *unless* the debtor expressly agreed on his liability in case of fortuitous events (where he acts as “insurer”) (*See TS, Dec. 15, 1926*);
- (c) the debtor is not yet in default. (*TS, May 21, 1904*).]

**Commercial Credit Corp. of Cagayan
de Oro v. CA and the Cagayan
de Oro Coliseum, Inc.
GR 78315, Jan. 2, 1989**

Art. 1229 of the Civil Code applies only to an obligation or contract, subject of a litigation, the condition being that the same has been partly or irregularly complied with by the debtor. Said *proviso* also applies even if there has been no performance, as long as the penalty is iniquitous or unconscionable. It cannot apply to a final and executory judgment.

When the parties entered into the compromise agreement and submitted the same for the approval of the trial court, its terms and conditions must be the primordial consideration why the parties voluntarily entered into the same. The trial court approved it because it is lawful, and is not against public policy or morals. Even the respondent Court of Appeals upheld the validity of the said compromise agreement. Hence, the respondent court has no authority to reduce the penalty and attorney's fees therein stipulated which is the law between the parties and is *res judicata*.

**Insular Bank of Asia and America v. Salazar
GR 82082, Mar. 25, 1988**

The Civil Code permits the agreement upon a penalty apart from the interest. Should there be such an agreement, the penalty does not include the interest, and as such the two are different and distinct things which may be demanded separately. The stipulation about payment of such additional rate partakes of the nature of a penalty clause, which is sanctioned by law.

Art. 1230. The nullity of the penal clause does not carry with it that of the principal obligation.

The nullity of the principal obligation carries with it that of the penal clause.

COMMENT:**(1) Effect of Nullity of the Penalty Clause**

If the principal obligation is null and void, the penal clause will have no more use for existence and is therefore also considered null and void. Upon the other hand, just because the penal clause is not valid, it does not mean that its nullity will also make the principal obligation null and void. *Reason:* The principal obligation can stand alone, and the void penal clause will just be disregarded.

(2) Examples

- (a) A is obliged to give B a pack of shabu. There is a penal clause regarding the forfeiture of P500,000 in case of non-compliance of the obligation. Here, the subject matter is outside the commerce of man. The penalty clause here, although in itself valid, will also be considered null and void because “the nullity of the principal obligation carries with it that of the penal clause.” (*Art. 1230, 2nd paragraph, Civil Code*).
- (b) A is obliged to construct a house for B within 6 months. The contract provides for a penalty clause in case A is not able to perform his obligation within the stipulated period. The penal clause consists of the giving by A to B of several tins of opium. *Here the penalty clause is null and void because opium is outside the commerce of man. But the principal obligation, that of constructing the house, remains valid. The penal clause will be disregarded. The law provides that “the nullity of the penal clause does not carry with it that of the principal obligation.” (Art. 1230, par. 1, Civil Code).*

Chapter 4

EXTINGUISHMENT OF OBLIGATION

GENERAL PROVISIONS

Art. 1231. Obligations are extinguished:

- (1) By payment or performance;**
- (2) By the loss of the thing due;**
- (3) By the condonation or remission of the debt;**
- (4) By the confusion or merger of the rights of creditor and debtor;**
- (5) By compensation;**
- (6) By novation.**

Other causes of extinguishment of obligations, such as annulment, rescission, fulfillment of a resolutive condition, and prescription, are governed elsewhere in this Code.

COMMENT:

(1) Classification by CASTAN of Causes of Extinguishment of Obligations

- (a) Voluntary; and**
- (b) Involuntary**

Voluntary Causes:

- (a) Performance**
 - 1) payment or performance**
 - 2) consignation**

- (b) Substitution of performance
 - 1) compensation
 - 2) novation
 - 3) *dacion en pago (datio in solutum)*
- (c) Agreement to release
 - 1) *subsequent to obligation*:
 - a) unilateral waiver
 - b) natural waiver
 - c) remission
 - d) mutual dissent (*disenso*)
 - e) compromise
 - 2) *simultaneous with creation of obligation*:
 - a) resolutive term or extinctive period
 - b) resolutive condition or condition subsequent

Involuntary Causes:

- (a) By failure to bring an action

Example: prescription of the right of action (Statute of limitations)
- (b) Resolutive condition or condition subsequent

Examples: 1) merger or confusion

 - 2) in personal obligations — by the death of a party
 - 3) change of civil status (in obligations because of family relations)
- (c) By reason of the object

Examples: 1) Impossibility of performance

 - 2) Loss of the thing due

(2) Classification According to the Civil Code

- (a) Ordinarily by

- 1) payment or performance
 - 2) loss of the thing due
 - 3) condonation or remission of the debt or waiver
 - 4) confusion or merger of the rights of creditor and debtor
 - 5) compensation
 - 6) novation (*Art. 1231, Civil Code*)
- (b) Other causes mentioned in Art. 1231 of the Civil Code but governed under *other Chapters* of the Code
- 1) annulment
 - 2) rescission
 - 3) fulfillment of a resolutory condition
 - 4) prescription
- (c) *Still other causes*
- 1) death of a party in case the obligation is a personal one (as when a singer, hired to perform at a concert, dies before the concert begins)
 - 2) *resolutory term* — (here the obligation ceases upon the arrival of the term)
 - 3) *change of civil status* — (as when a married woman becomes a widow, or when an unmarried woman gets married)
 - 4) compromises
 - 5) mutual dissent (as when both parties to a contract refuse to go ahead with the contract)
 - 6) impossibility of fulfillment
 - 7) fortuitous event

**Commissioner of Internal Revenue
v. William J. Suter &
the Court of Tax Appeals
L-25532, Feb. 28, 1969**

FACTS: A limited partnership named “William J. Suter ‘Morcoin’ Co., Ltd.” was formed on Sept. 30, 1947 by William J.

Suter as general partner (one liable even beyond his contribution), and Julia Spirig and Gustav Carlson, as limited partners (those liable only to the extent of their contributions). In 1948, Suter and Spirig got *married*, and sometime later, Carlson sold his share in the partnership to Suter and his wife. *Issue*: Did the marriage dissolve or put an end to the partnership?

HELD: No, the marriage did not dissolve the partnership. While spouses cannot enter into a *universal* partnership, they can enter into a *particular* partnership or be members thereof. The contract was *not*, therefore, ended.

Lamberto Torrijos v. Court of Appeals
L-40336, Oct. 24, 1975

FACTS: In 1964 Torrijos purchased a lot from Diamnuan. Later Torrijos learned that in 1969 Diamnuan sold the same lot to De Guia. Torrijos initiated an estafa complaint against the seller, who was convicted. During the appeal in the Court of Appeals, the accused Diamnuan died. His lawyer filed a motion to dismiss alleging that the death of his client, prior to final judgment, extinguished both the personal and the pecuniary penalties. *Issue*: Is the civil liability also extinguished?

HELD: The civil liability here is not extinguished, because *independently* of the criminal case, the accused was civilly liable to Torrijos. If after receiving the purchase price from Torrijos, he failed to deliver the property (even before selling it again to De Guia), there would as yet be no estafa, but there is no question of his civil liability thru an action by Torrijos either for specific performance plus damages or rescission plus damages. Death is not a valid cause for the extinguishment of a civil obligation. Had the only basis been the commission of estafa, it is clear that the extinguishment of the criminal responsibility would also extinguish the civil liability, provided that death comes before final judgment. Furthermore, under Arts. 19, 20, and 21 of the Civil Code, the accused would be civilly liable independently of the criminal liability for which he can be held liable. And this civil liability exists despite death prior to final judgment of conviction.

Lazaro v. Sagun
78 SCRA 100

The death of a lawyer renders moot and academic charges against him for unethical acts.

Section 1

PAYMENT OR PERFORMANCE

Art. 1232. Payment means not only the delivery of money but also the performance, in any other manner, of an obligation.

COMMENT:

(1) ‘Payment’ Defined

Payment is that mode of extinguishing obligations which consists of:

- (a) the delivery of money, or
- (b) the performance in any other manner of an obligation.
(*Example: rendition of the required service*).

(2) Pre-Existing Obligation

A person pays a *pre-existing* obligation. If no such obligation exists, strictly speaking there is no payment.

Example:

A was given the option to buy a car or not, within the period of one week. Here, A has no duty to buy. But if he decides to buy, an obligation is created and he must pay. (See *Asturias Central v. Pure Cane Molasses Co.*, 60 Phil. 259, where it was held that a “payment” made because of a reserved right or option or privilege is not governed by Arts. 1232 to 1262, because such “payment” cannot be demanded by the creditor.)

(3) Acceptance by Creditor

For payment to properly exist, the creditor has to *accept* the same, *expressly* or *implicitly*. Payment, for valid reasons, may properly be rejected. (*TS, May 18, 1943*).

(4) Effect of Payment Made Under a Void Judgment

If the judgment upon which the aggrieved party made payment is null and void, the *payment* made thereunder is also null and void. (*Manila Surety and Fidelity Co. v. Lim*, L-9343, Dec. 29, 1959).

Art. 1233. A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be.

COMMENT:**(1) Completeness of Payment**

Requisites for a valid payment under this Article:

- (a) The very *thing* or *service* contemplated must be paid.
- (b) Fulfillment must be complete. (*Ramos v. Ledesma*, 12 Phil. 656).

(2) How Payment or Performance Is Made

- (a) If the debt is a monetary obligation, by delivery of the money. The amount paid must be full, unless of course otherwise stipulated in the contract.

[NOTE: The term “indebtedness” has been defined as an unconditional and legally enforceable obligation for the payment of money. (*Commissioner of Int. Rev. v. Prieto*, L-13912, Sept. 30, 1960). Within that definition, it is apparent that a tax may be considered as an indebtedness. (See *Sambrano v. Court of Tax Appeals, et al.*, 53 O.G. 4839).]

- (b) If the debt is the delivery of a thing or things, by delivery of the thing or things.
- (c) If the debt is the doing of a personal undertaking, by the performance of said personal undertaking.
- (d) If the debt is *not doing* of something, by refraining from doing the action.

(3) Burden of Proof

- (a) An alleged creditor has the burden of showing that a valid debt exists.
- (b) Once he does this, the debtor has the burden of proving that he has paid the same. (*Lopez v. Tan Tioco*, 8 Phil. 693). Thus, if a promissory note is still in the creditor's possession, the presumption is that it has not yet been paid. (*Bantug v. del Rosario*, 11 Phil. 511).

(4) Means of Proving Payment

One good proof is the presentation of the receipt. (*Toribio v. Fox*, 34 Phil. 913). A debtor is justified in demanding that a creditor issue a receipt when the debt is paid. (*TS*, Jan. 5, 1911; see Art. 1256, Civil Code).

Javier v. Brinas
(C.A.) 40 O.G. 4th Supp. No. 8, p. 279

FACTS: A borrowed money from B, the debt to be paid in installments. There were several receipts, each of which acknowledged the payment of a certain installment. B brought an action against A for installments not covered by receipts. A's defense was that he had paid the whole debt but that he could not show all the receipts for all the installments because there were instances when in his dealings with the creditor, no receipt was issued in his favor. *Issue:* Is A's testimony sufficient to establish or prove the fact that the whole debt had been paid?

HELD: No, his testimony does not constitute sufficient proof that the entire debt has been paid. His testimony is in fact incompatible with the usual procedure between him and B, the creditor, as evidenced by the fact that in their transactions, receipts were issued.

(*NOTE:* It must be recalled at this stage, however, that a receipt for a *later installment* establishes the presumption that prior or previous installments have been paid or discharged.)

- (5) In a *usury* case, it has been held that the mere fact that the interest is usurious does not necessarily mean that the loan is void. After all, the loan itself is the *principal* contract. The stipulation regarding interest may be regarded as *merely accessory*. The principal of the loan must still be paid, otherwise it remains unpaid.

Gui Jong & Co. v. Rivera and Avellar
45 Phil. 778

FACTS: Rivera borrowed money from Gui Jong and Co. at a usurious rate, secured by a mortgage. When asked for payment, he said that his obligation has been extinguished because the contract is usurious. *Issue:* Is he correct? If the lender now desires to foreclose, may he do so?

HELD: The obligation to pay the principal (and the lawful interest) has not been extinguished and in case of non-payment thereof, foreclosure is proper.

Art. 1234. If the obligation has been substantially performed in good faith, the obligor may recover as though there has been strict and complete fulfillment, less damages suffered by the obligee.

COMMENT:

Substantial Performance in Good Faith

- (a) The above rule (*Art. 1234*) is adopted from American Law. Its fairness is evident. In case of substantial performance, the obligee is benefited. So the obligor should be allowed to recover as if there had been a strict and complete fulfillment, less damages suffered by the obligee. This last condition affords a just compensation for the relative breach committed by the obligor. (*Report of the Code Commission, p. 131*).
- (b) It must be noted that the liability of the debtor for damages suffered by the creditor in case of substantial performance does not arise under the conditions set forth in Art. 1235 of the Civil Code.

- (c) Inasmuch as substantial performance in good faith may already be equivalent to “fulfillment” or “payment,” it follows that the right to rescind (mentioned in Art. 1191) cannot be used simply because there have been slight breaches of the obligation. In fact, such right to rescind is *not absolute*, and therefore the Court may even grant, at its discretion, a period to a person in default, within which the obligation can be fulfilled. (*See Gaboya v. Cui, L-19614, Mar. 27, 1971*).

Rosete, et al. v. Perober Dev. Corp.
CA-GR 61032-R
Jul. 31, 1981

Substantial performance or compliance is, in a sense, a performance according to the fair intent of the contract, with an attempt in good faith to perform.

Fair dealing and equity demand a faithful compliance of one’s contractual obligations.

Art. 1235. When the obligee accepts the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection, the obligation is deemed fully complied with.

COMMENT:

(1) Estoppel on the Creditor’s Part in View of His Acceptance

Reason for the Article: The presence of WAIVER and ESTOPPEL.

(2) Qualified Acceptance

Note that under this Article, there is a possibility that a *protest* or *objection* can be made. Hence, there is what is called “*qualified acceptance* of incomplete or irregular payment.” Be it remembered that a creditor who gives a *receipt* for a partial payment does not necessarily acquiesce to such incomplete payment. His actions may show his dissatisfaction. (*Esguerra*

v. Villanueva, L-23191, Dec. 19, 1967). Thus, a creditor may conditionally accept performance by the debtor *after* the time of maturity, but with the stipulation that the surety or the guarantor of the debtor should give CONSENT. This is to prevent the surety or guarantor from later on alleging that the creditor had given an extension of time to the debtor. In this way, the surety or guarantor *cannot* claim that he has been released from the obligation. (*Joe's Electrical Supply v. Alto Electronic Corp., L-12376, Aug. 22, 1958*).

(3) Case

Constante Amor de Castro v. CA GR 115838, Jul. 18, 2002

The word “accept,” as used in Art. 1235 of the Civil Code, means to take a satisfactory or sufficient, or agree to an incomplete or irregular performance.

In the case at bar, the mere receipt of a partial payment is not equivalent to the required acceptance of performance as would extinguish the whole obligation.

Art. 1236. The creditor is not bound to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is a stipulation to the contrary.

Whoever pays for another may demand from the debtor what he has paid, except that if he paid without the knowledge or against the will of the debtor, he can recover only insofar as the payment has been beneficial to the debtor.

COMMENT:

(1) Right of Creditor to Refuse Payment by Third Person

The creditor can refuse payment by a stranger (3rd person) except:

- (a) if there is a stipulation allowing this;

- (b) or if said third person has an interest in the fulfillment of the obligation (co-debtor, guarantor, even a joint debtor). (*Monte de Piedad v. Rodrigo*, 63 Phil. 312).

(2) Comment of the Code Commission

What is the reason of the Code Commission in recommending that the creditor should not be compelled “to accept payment or performance by a third person who has no interest in the fulfillment of the obligation, unless there is stipulation to the contrary?”

ANS.: “Under the old Civil Code, the creditor cannot refuse payment by a third person but the Commission believes that the creditor should have a right to insist on the liability of the debtor. Moreover, the creditor should not be compelled to accept payment from a third person whom he may *dislike* or *distrust*. The creditor may not, for personal reasons, desire to have any business dealings with a third person; or the creditor may not have confidence in the honesty of the third person who might deliver a defective thing or pay with a check which may be honored.” (*Report of the Code Commission*, p. 132).

(3) Observation of Justice J.B.L. Reyes

No good reason exists for departing from the rule of the Spanish Code (*Art. 1158*) that payment may be made by a stranger where the obligation is not *intuitu personae*. Such rule (*Art. 1158, old Code*) is justified by:

- (a) the existence of the quasi-contract of *negotiorum gestio* of which payment for another is but a variant; and
- (b) the evolution of the concept of ordinary obligation from a relation of person to person (as it was in Roman Law), to a relation of patrimony to patrimony in the modern law. Where no *personal qualities* are involved, what interest does the creditor have in seeing that the performance should be by A or B? As for the debtor, he is protected by the second paragraph of Art. 1236, and by Art. 1237. The first paragraph of Art. 1236 should be eliminated.” (*Quoted in Tolentino, Civil Code*, Vol. 4, p. 246).

(4) Payment by a Third Person (BAR)

The third person may pay:

- (a) with the knowledge and consent of the debtor. (Here, the payor is entitled to REIMBURSEMENT and SUBROGATION to such rights as *guaranty, penalty clause, or mortgage*.) (See Art. 1237; see also *De Guzman v. Santos*, 68 Phil. 371).
- (b) without the debtor's knowledge or *against* his will. (Here, the payor is *not* entitled to subrogation; moreover, he is allowed only BENEFICIAL REIMBURSEMENT.)

(*Example*: If *X* pays for *Y*'s transportation fare, without *Y*'s knowledge, or against *Y*'s will, and later discovers that *Y* was entitled to HALF-FARE, *X* can recover only said half-fare, even if he had paid the FULL FARE. This is clearly the fault of *X*.)

[NOTE: In the example given, can *X* recover *Y*'s half-fare from the creditor?

HELD: No, for this is not *solutio indebiti* (for said half-fare was really due). *X*'s right is against *Y*, the debtor, for said half-fare. (See *Bank of P.I. v. Trinidad*, 42 Phil. 223 and *Monte de Piedad v. Fernando Rodrigo*, 63 Phil. 312). The remaining half-fare, which was NOT even due the creditor, is of course *undue payment* or *solutio indebiti* and may properly be recovered from the creditor. (8 *Manresa* 270).]

[NOTE: Other instances when recovery can be had from the creditor and not from the innocent debtor:

- a) when the debt had prescribed
- b) when the debt had been completely remitted
- c) when the debt has already been paid
- d) when legal compensation had already taken place. (8 *Manresa* 270).]

Example:

A owes *B* P1,000,000. Later, *A* paid *B* P700,000, leaving a balance of P300,000. *C*, a classmate of *A*, and intend-

ing to surprise *A*, paid *B* the sum of P1,000,000 thinking that *A* still owed *B* that amount. He did this *without knowledge* of *A*. How much can *C* recover from *A*?

ANS.: *C* can recover only P300,000 from *A*, because it is only up to this amount that *A* has been benefited. *C* can recover the remaining P700,000 from *B* who should not have accepted complete payment for a debt already partially paid. If *B* incidentally is in bad faith, *B* is responsible not only for the return of the P700,000 but also for the interest in lieu of damages.

In the preceding problem, suppose the payment by *C* had been made against the will of *A*, would your answer be the same?

ANS.: Yes, the answer would be the same. The law makes no distinction as to the right of recovery in case payment by a stranger was made either *without the knowledge* or *against the consent* of the debtor. In both cases, the paying stranger “can recover only insofar as the payment has been beneficial to the debtor.” (*Art. 1236, 2nd paragraph, Civil Code*).

(5) Cases

Agoncillo v. Javier **38 Phil. 424**

FACTS: *D* owes *C*. Without *D*'s knowledge, *X*, a friend, paid *C* part of *D*'s debt. So, *D* still owes the *remainder*. Does *X*'s payment of part of the debt *prevent* the running of the prescriptive period regarding the remaining part?

HELD: No, because in no way may *D* be said to have acknowledged the existence of the debt.

Gonzaga v. Garcia **27 Phil. 7**

FACTS: Francisco sold a parcel of land *a retro* to somebody. In the registry records, the right to repurchase was therefor annotated. Francisco sold later this right of repurchase to Del

Rosario who in turn sold the same to Gonzaga. Francisco later paid on his own behalf the repurchase money to the buyer *a retro*, and the annotation of the right to redeem in the Registry of Property was cancelled. Gonzaga now seeks to have the land registered under his name on the theory that Francisco had paid for his (Gonzaga's) "debt," and therefore the land now properly belongs to him (Gonzaga).

HELD: Petition of Gonzaga will not prosper, because Art. 1236, being applicable only to "debts," cannot be used in this case. Gonzaga was not a true debtor. While Gonzaga had the right to repurchase, such right was only a right, not a duty. In a true debt, there is a duty. In a case of the right to repurchase, whether or not the property would be repurchased depends entirely on Gonzaga. Therefore, Francisco's act of repurchasing did not make Del Rosario or his transferree, Gonzaga, the owner, cannot have the land registered under his name.

[NOTE: Had Francisco acted as *agent* for Gonzaga, or had Francisco's act been a case of *negotiorum gestio*, the answer would have been different. (See *Sison v. Balgos*, 34 Phil. 885, where the Court held that an uncle of certain wards, whether appointed legal guardian for them or not, is allowed under the law to repurchase or redeem property in behalf of the minors, inasmuch as even a third person, who is a *complete stranger*, may pay for someone *under Art. 1236*).]

Mitsui Bussan Kaisha v. Meralco
39 Phil. 624

FACTS: Plaintiff, a seller in Japan, sold to defendant, a buyer, some coal. While delivery was being made, the Phil. Legislature imposed a specific tax of P1 per metric ton of coal. So that the coal could enter Manila, the plaintiff paid this tax. When defendant was asked for reimbursement, defendant refused to pay. Hence, plaintiff brought this action.

- Issues:*
- 1) Who should really pay the tax?
 - 2) If buyer should really pay the tax, may seller recover from the buyer what has been paid for the taxes, even though said payment was effected without the consent of the buyer?

HELD: (1) The buyer should really pay the tax. Although the Act provides that the seller *may* pay the tax, as is practised under our revenue system, still the ultimate liability should fall upon the buyer.

(2) Since the seller, therefore, merely paid in behalf of the buyer, the seller can now recover the tax paid from the buyer, notwithstanding the fact that the buyer's consent had not been previously obtained. What can be recovered is that amount which has benefited the buyer (debtor of the tax), and in this case, the amount of benefit was clearly the whole tax.

(**NOTE:** Under Art. 2175 of the Civil Code, the following is expressly provided: "Any person who is constrained to pay the taxes of another shall be entitled to reimbursement from the latter.")

**Rehabilitation Finance Corp. v.
Court of Appeals, et al.
94 Phil. 985**

In this case, the Court made the following rulings:

- 1) As to whether or not payment by a third person really benefited the debtor is a matter to be brought up by the debtor, and not the creditor, for having given consent to the stranger's payment, the debt is already paid, and as creditor, he now steps out of the picture. Moreover, only the debtor's rights are affected.
- 2) Once the creditor has accepted payment from a stranger, it cannot *later* on require the permission of the debtor to the payment.
- 3) Here also, the Supreme Court said that if the stranger pays with the *knowledge* of the debtor who keeps quiet and does *not object*, it is as if the debtor had really consented. The debtor is not allowed to protest long after the payment. His conduct at the time of payment is what counts.

[**NOTE:** The knowledge of the debtor that someone is paying for him can be proved *inferentially* and by his conduct. (See *De Guzman v. Santos*, 68 Phil. 371).]

**Chonney Lim v. CA, Lea
Castro Whelan & Keith Lawrence Whelan
GR 104819-20, Jul. 20, 1998**

The payment of the loan and capital gains tax undoubtedly relieved the appellant from such obligations. The benefit had even been mutual, both appellant and appellee had obtained advantages on their sides — the appellant from his loan, and appellee from being secured of the possession.

This Court finds no error in ruling that petitioner Lim is not entitled to rescission of the contract. It cannot be denied that Chonney Lim is also not without fault in this case. It was Lim's obligation to see to it that the property was free from all encumbrances and tax liabilities, *inter alia*, which he obviously failed to do. The respondent court's ruling in considering the payment of the mortgage loan and the capital gains tax by Lea Whelan as her full payment for the property is but a fair disposition which this Court does not see any cogent reason to reverse.

Art. 1237. Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, guaranty, or penalty.

COMMENT:

(1) When No Subrogation Exists

This Article is an amendment of Art. 1159 of the old Civil Code. Under the article of the old Civil Code, no mention was made in case the payor paid against the will of the debtor. Furthermore, no examples of subrogation were made. The amendment, however, does not effect any radical change in the law inasmuch as even under the old Civil Code, our jurisprudence has ruled that one who pays without the knowledge of the debtor has no right to subrogation. Hence, with less reason should a payor against the will of the debtor be entitled to subrogation. Under the old Civil Code too, the concept of subrogation and the rights it carried were well known; hence, the New Civil Code article in this respect has not made any substantial change.

(2) ‘Subrogation’ Defined

Subrogation means the act of putting somebody into the shoes of the creditor, hence, enabling the former to exercise all the rights and actions that could have been exercised by the latter. The law says: “Subrogation transfers to the person subrogated the credit with all the rights thereto appertaining, either against the debtor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation.” (*Art. 1303, Civil Code*).

(3) Some Rights Which May Be Exercised by the Person Subrogated in the Place of the Creditor

The rights arising from:

- (a) a mortgage;
- (b) a guaranty;
- (c) a penalty or penal clause.

(4) Problems

- (a) *A* borrowed P1 million from *B*. The loan was secured by a mortgage of *A*’s land in favor of *B*. *Without* the knowledge of *A*, *C* paid *B* the sum of P1 million for *A*’s debt. *A* benefited to the amount of P1 million.

- 1) May *C* claim reimbursement from *A*?
- 2) If so, how much?
- 3) If *A* cannot pay, may *C* foreclose the mortgage on *A*’s land?

ANS.:

- 1) Yes, *C* can claim reimbursement from *A* inasmuch as *C* paid *A*’s debt.
- 2) *C* can recover the whole amount of P1 million inasmuch as the problem states that *A* benefited up to the amount of P1 million.
- 3) If *A* cannot pay, *C* cannot foreclose the mortgage on *A*’s land. It is true that the original creditor *B* had the right to foreclose in case of non-payment, BUT in this case, the new creditor *C* had not been subro-

gated in the rights of *B*, inasmuch as *C* paid without the knowledge of *A*. The only right of *C* therefore is reimbursement up to the amount *A* had benefited, but NOT the right of subrogation. “Whoever pays on behalf of the debtor without the knowledge or against the will of the latter, cannot compel the creditor to subrogate him in his rights, such as those arising from a mortgage, etc.” (*Art. 1237, Civil Code*).

[NOTE: If in problem (a), *C* had paid *A*’s debt against the will of *A*, would your answer be the same?

ANS.: Yes, the answer would be the same, inasmuch as the law gives the same rights to one who pays without the knowledge and to one who pays against the will of the debtor. (*Art. 1237, Civil Code*).]

- (b) *A* owes *B* the sum of P1 million. *C* is the guarantor of *A*. *A* was able to pay *B* the sum of P400,000. Therefore, P600,000 still remains unpaid. *D*, thinking that *A* still owed *B* P1 million paid P1 million to *B*, against the will of *A*.
- 1) May *D* recover from *A*?
 - 2) If so, how much?
 - 3) If *A* cannot pay, may *D* proceed against the guarantor *C*?

ANS.:

- 1) Yes, *D* may recover from *A*.
- 2) *D* can recover only P600,000 because this is the only amount which benefited *A*. Remember that previously P400,000 had been paid, leaving a balance of merely P600,000.
- 3) If *A* cannot pay, *D* cannot ordinarily proceed against the guarantor *C* because *D*, having paid against the will of *A*, is not entitled to subrogation.

(5) Questions

- (a) Suppose a payor pays the creditor with the express or implied consent of the debtor, what are the rights of the payor?

ANS.: A payor in this case would be entitled not merely to full reimbursement but also to subrogation, or the right to bring actions against the debtor as mortgagee or against third persons.

- (b) Is there any specific provision of the law supporting the answer in (a)?

ANS.: Yes. Art. 1302 of the Civil Code states that: "It is presumed that there is *legal subrogation* x x x (2) when a third person, not interested in the obligation, pays with the express or tacit approval of the debtor."

- (c) Art. 1237 says the payor "cannot compel the creditor, but this is NOT the meaning of the law, for subrogation can take place only if the payment had been made with the knowledge and without the objection of the debtor. What the law, therefore, means is that such payor as is referred to in Art. 1237 "*is not entitled to subrogation.*"

(6) 'Subrogation' Distinguished from 'Reimbursement'

In subrogation, recourse can be had to the mortgage or guaranty or pledge; in reimbursement, there is no such recourse.

In subrogation, the debt is extinguished in one *sense*, but a new creditor, with exactly the same rights as the old one, appears on the scene. In reimbursement, the new creditor has different rights, so it is as if there has indeed been an extinguishment of the obligation.

In subrogation, there is something more than a personal action of recovery; in reimbursement, there is only a personal action to recover the amount. (*8 Manresa 269*).

(7) Similarity

Note, however, that in both reimbursement and subrogation, there can be recovery of what the stranger "*has paid*" (not necessarily the amount of the credit). (*See Art. 1236, 2nd paragraph, Civil Code*).

Art. 1238. Payment made by a third person who does not intend to be reimbursed by the debtor is deemed to be a donation, which requires the debtor's consent. But the payment is in any case valid as to the creditor who has accepted it.

COMMENT:

(1) When Payment by Stranger Is Deemed a Donation

Reason why debtor has to consent — No one should be compelled to accept the generosity of another. (*Report of the Code Commission, p. 132*).

(2) Example

A owes B P1 million. C, in behalf of A, pays B P1 million against the consent of A, although C had previously told A that he (C) did not intend to be reimbursed. Needless to say, B accepted the payment by C in behalf of A.

- (a) Is A's obligation towards B extinguished?
- (b) May C still recover from A, because of the fact that A did not consent to what the law deems a donation on the part of C in favor of A?

ANS.:

- (a) Yes, A's obligation toward B is extinguished even if A did not consent to the donation. The law says: "But the payment is in any case valid as to the creditor who has accepted it." (*2nd sentence, Art. 1238, Civil Code*).
- (b) Yes, C may still recover from A, although originally C did not intend to be reimbursed. This is so because here there has been no real donation. However, inasmuch as the payment by C had been effected against the will of A, all that C can recover from A is to the extent that A has been benefited by C's payment to B in A's behalf.

Art. 1239. In obligations to give, payment made by one who does not have the free disposal of the thing due and capacity to alienate it shall not be valid, without prejudice to the provisions of Article 1427 under the Title on "Natural Obligations."

COMMENT:**(1) Payment by an Incapacitated Person**

General Rule — If person paying has no capacity to give:

- (a) payment is not valid — if accepted;
- (b) creditor cannot even be compelled to accept it;
- (c) the remedy of consignation would not be proper. (*8 Manresa 267*).

Exception (as provided for in Art. 1427, *Civil Code*):

“When a minor between eighteen and twenty-one years of age, who has entered into a contract without the consent of the parents or guardian voluntarily pays a sum of money or delivers a fungible thing in fulfillment of the obligation, there shall be no right to recover the same from the obligee who has spent or consumed it in good faith.”

(2) Example of the Exception

A, a minor, entered into a contract without the consent of his parents. In said contract, A was supposed to pay to B the sum of P1 million. B did not know of A's minority, and when A voluntarily paid him the money, B accepted the sum. Out of this amount, B spent P800,000. Later, the parents of A learned of the transaction, and brought an action in court to recover the P1 million paid to B. How much can the parents recover from B?

ANS.: The parents can recover only P200,000 inasmuch as the P800,000 had already been spent in good faith.

[*NOTE:* While Art. 1239 refers to payment *by* an incapacitated person, Art. 1241 refers to payment *to* an incapacitated person.]

Art. 1240. Payment shall be made to the person in whose favor the obligation has been constituted, or his successor in interest, or any person authorized to receive it.

COMMENT:**(1) To Whom Payment Must Be Made**

- (a) to the person in whose favor the obligation has been constituted (the creditor);

[NOTE: This refers to the creditors at the time of payment, *not* the original creditor at the time the obligation was constituted. (*Tuason and San Pedro v. Zamora and Sons*, 2 Phil. 305).]

- (b) to the *successor-in-interest* (like the heirs);
- (c) to any person *authorized* to receive it.

(NOTE: The authorization may be by *agreement* or by *law*.)

[NOTE: If the recipient was not authorized, the payment generally is NOT valid (without prejudice to Art. 1241). (*Keeler Elec. Co. v. Rodriguez*, 44 Phil. 19; *Ormachea v. Trillana*, 13 Phil. 194; and *Crisol v. Claveron*, 38 O.G. No. 156, p. 3734).]

(2) Cases

Harry E. Keeler Electric Co. v. Rodriguez
44 Phil. 19

FACTS: Rodriguez owed the company a certain amount of money. One Montelibano approached Rodriguez and claimed that he (Montelibano) was duly authorized to receive payment for the company. Without making any verification, Rodriguez paid Montelibano. Later, the company sued Rodriguez for payment of debt. Rodriguez presented the defense that he had already paid his debt to Montelibano who was not authorized to receive payment. *Issue:* Should Rodriguez still pay his debt to the company?

HELD: Yes. Rodriguez's payment to Montelibano was not valid because Montelibano was not duly authorized to receive such payment. Payment to an unauthorized agent is at the risk of the payor. Rodriguez should have made a proper verification.

Ormachea v. Trillana
13 Phil. 194

FACTS: Plaintiff was formerly a member of a partnership, and upon dissolution of said partnership, he was given the right to collect the debts due the partnership. Plaintiff sued the defendant. Defendant presented a note signed by Lawa, the former administrator of the partnership, to the effect that defendant's debt had already been extinguished. However, the *vales* still remained in the possession of the plaintiff.

ISSUES:

- 1) What is the value of the *vales* being still in the hands of the plaintiff?
- 2) Was Lawa authorized to say that the obligation of the defendant was extinguished, even if at that time Lawa was no longer the administrator of the partnership (which incidentally has already been dissolved)?
- 3) Should the defendant pay the plaintiff?

HELD:

- 1) The *vales* still in the hands of the plaintiff constitute a presumption that the debt of the defendant has not yet been paid.
- 2) Lawa was not authorized to say that the obligation of the defendant was extinguished because Lawa was at that time no longer authorized to receive payments in behalf of the partnership. Had he been duly authorized to do so, this fact would have rebutted the presumption regarding the non-payment of the debt, and would have extinguished the debt inasmuch as presumably it had been paid to one authorized to receive the payment.
- 3) Yes, the defendant should pay the plaintiff because the defendant has not succeeded in proving that his debt has been paid.

Crisol v. Claveron
38 O.G. No. 156, p. 3734

FACTS: Crisol was the creditor of Claveron. When Crisol's first wife died, he distributed the property among his children.

Later Crisol married again. After Crisol's death the children asked Claveron to pay them his debt. Claveron instead paid the second wife, who was declared unauthorized by the court. *Issue*: Is Claveron's debt extinguished?

HELD: No, Claveron's debt is not extinguished because the person to whom he had made the payment was not authorized to receive it. Besides, the heirs of Crisol had already made a demand upon Claveron, yet Claveron refused to heed said demand. He must now pay for his stubbornness.

(3) Payment Made to Authorized Entities

Payment made to entities authorized by an occupation government (like the Japanese occupation government in the Philippines) of debts in favor of enemy persons and corporations, should be considered as valid, because a belligerent military occupant has the right under International Law to sequester or freeze the assets of the enemy. (*Haw Pia v. China Banking Corp.*, 80 Phil. 604).

Haw Pia v. China Banking Corporation 80 Phil. 604

FACTS: Haw Pia owed defendant a sum of money (Philippine pesos) secured by a mortgage. During the Japanese occupation, the Bank of Taiwan was given the right by the Military Administration to liquidate the assets of enemy banks. Haw Pia then paid off the mortgage, not to the defendant, but to the Bank of Taiwan. Liberation came. Haw Pia is now asking for the cancellation of the mortgage on the ground that it had been paid. The defendant refused, and on the contrary asked for payment of the debt.

ISSUES:

- (a) Had the Japanese Military Administration the right to liquidate and freeze the assets of enemy banks?
- (b) Did payment by Haw Pia to the Bank of Taiwan extinguish the debt?
- (c) Was Japanese money then legal tender?

HELD:

- (a) Yes, the Japanese Military Administration, under the principles of international law, had the right to liquidate and freeze the assets of enemy banks. What it did was not confiscation, but merely liquidation so as to freeze assets.
- (b) Yes, payments by Haw Pia to the Bank of Taiwan extinguished the mortgage debt, inasmuch as under the law then prevailing, the Bank of Taiwan was authorized to receive payment. Hence, the mortgage should be cancelled.
- (c) Yes, the Japanese Military notes was legal tender because under International Law, the invading power has the right to issue currency for circulation here.

Subsidiary Issue: Does not the fact that the obligation here to pay in Philippine peso make it an obligation to pay in a specified specie?

HELD: True, the obligation was to pay in Philippine pesos, but this was not a stipulated specie, but obviously referred only to the legal tender since after all, the most common occurrences are transactions in Philippine pesos. It was never the intention of the parties to specify that only Philippine pesos, of pre-war valuation, may be paid. The use of the term "Philippine peso" here is merely incidental.

**Everett Steamship Corporation v.
Bank of the Philippine Islands
84 Phil. 202**

FACTS: Plaintiff is a corporation in Manila, the majority stockholders of which are American and British citizens. Defendant is a banking corporation. Before December 1941, plaintiff had a current account with the defendant, and on December 29, 1941, the plaintiff had a valid balance in its favor of P53,175.51, Philippine currency. During the Japanese occupation, the officers of the plaintiff corporation were interned by the Japanese Armed Forces inside the UST compound. By order of the Japanese Military Administration, the defendant was made to turn over the account of the plaintiff to the Bank of Taiwan,

the depository of Enemy Properties. The defendant thus gave to the Bank of Taiwan a check in the sum of P53,175.51. After liberation, plaintiff wanted to draw the P53,175.51 it thought it still had, from the defendant bank. The latter pleaded payment to the Bank of Taiwan. *Issue*: May the plaintiff still recover from the defendant?

HELD: “In the instant case, the issue involved is whether the Japanese Military Administration could validly require the defendant-appellant to transfer to the Bank of Taiwan the balance of plaintiff’s current account with the defendant.”

“In the *Haw Pia* case the same issue was involved. The Court ruled in the *Haw Pia* case that the collection by the Bank of Taiwan of the China Banking Corporation’s credit from the latter’s debtor, by order of the Japanese military administration, was valid and released the defendant’s obligation to the plaintiff.”

Republic v. Grijaldo
L-20240, Dec. 31, 1965

FACTS: In 1943, a borrower obtained loans from the Bank of Taiwan. After the war, the Republic of the Philippines sought to recover the loans. It was alleged by the debtor that the Republic had no right to collect since the real creditor was the Bank of Taiwan. It was further alleged that the loan was a *private* contract between the borrower and the Bank, and that therefore the Republic could not legally collect.

HELD: It is true that the Bank of Taiwan was the original creditor, and that the transaction was a private contract. However, pursuant to the Trading with the Enemy Act as amended, and Ex. Order 9095 of the U.S., and under Vesting Order P-4, dated Jan. 21, 1946, the properties of the Bank of Taiwan were vested in the U.S. Government. Pursuant further to the Philippine Property Act of 1946, and the Transfer Agreements dated Jul. 20, 1954 and Jun. 15, 1957, the assets of the Bank were transferred to and vested in the Republic of the Philippines. Since the Republic is the *successor* to the rights in the loans, it is evident that there has been created a privity of contract between the Republic and the borrower, enabling the Republic to sue for collection.

[*NOTE*: If the money is paid to the wrong party in good faith, the debt is not extinguished. Moreover, the obligation carries with it the payment of interest and the interest continues to run. (*See Keeler Electric Co. v. Rodriguez*, 44 Phil. 19).]

Arcache v. Lizares & Co.
91 Phil. 348

FACTS: *D* owed *C*. Instead of paying *C*, *D* deposited the money in a bank *in the name and for the credit of C*. All these were done without *C*'s permission. *Issue*: Has the debt been extinguished?

HELD: No. But if after efforts had been made, the creditor could not be found, particularly at the place where payment is supposed to be made, the debtor *cannot* be held guilty of default.

Phil. Nat. Bank v. Ereneta, et al.
L-13058, Aug. 28, 1959

Under the old law, Rep. Act 897, the acceptance of backpay certificates in payment of loans to government corporations was indeed an obligation upon the Phil. Nat. Bank. However, the enactment of Rep. Act 1576, dated Jun. 16, 1965, which added a new provision, Section 9-a, to the Revised Charter of the PNB, removes this obligation imposed upon said Bank.

Josefina Ruiz de Luzuriaga Blanco v.
Compania General de Tabacos de Filipinas, et al.
L-10810, Nov. 29, 1960

FACTS: Plaintiffs entrusted certain bonds to the Tabacalera which they also made their depository, trustee, and attorney-in-fact. The bonds, issued by a Tarlac Sugar Central, fell due on or before Nov. 15, 1943. Before said date, the Central notified the Tabacalera of its intention to redeem said bonds. Tabacalera then allowed the redemption. The money obtained was then deposited in the Bank of Taiwan in the name of Tabacalera, as depository, trustee, and attorney-in-fact for plaintiffs. This was done, however, by Tabacalera without notifying the

plaintiffs first. With the advent of liberation, deposits with the Bank of Taiwan were rendered worthless. *Issue*: Was Tabacalera's act of consenting to the redemption valid and binding on the plaintiffs?

HELD: Yes, because under the terms of the bonds, the Sugar Central had the right to redeem the bonds on or before the date specified, and Tabacalera had been properly made the attorney-in-fact of the plaintiffs. No notice was needed — under the agreement between Tabacalera and the plaintiffs. Besides, the redemption was properly made in Japanese currency — which was then valid legal tender. Tabacalera was, therefore, right in surrendering the bonds that were being redeemed. Plaintiffs must, therefore, bear the loss.

**Rido Montecillo v. Ignacia Reynes & Sps. Redemptor
& Elisa Abucay
GR 138018, Jul. 26, 2002**

FACTS: Petitioner Montecillo's Deed of Sale does not state that the P47,000 purchase price should be paid by the former to Cebu Ice Storage (CIS). Montecillo failed to adduce any evidence before the trial court showing that Reynes had agreed, verbally or in writing that the P47,000 purchase price should be paid to CIS.

HELD: Absent any evidence showing that respondent had agreed to the payment of the purchase price to any other party, the payment to be effective must be made to respondent, the vendor in the sale. Thus, petitioner's payment to CIS is not the payment that would extinguish the former's obligation to respondent under the Deed of Sale.

Art. 1241. Payment to a person who is incapacitated to administer his property shall be valid if he has kept the thing delivered, or insofar as the payment has been beneficial to him.

Payment made to a third person shall also be valid insofar as it has redounded to the benefit of the creditor. Such benefit to the creditor need not be proved in the following cases:

(1) If after the payment, the third person acquires the creditor's rights;

(2) If the creditor ratifies the payment to the third person;

(3) If by the creditor's conduct, the debtor has been led to believe that the third person had authority to receive the payment.

COMMENT:

(1) Payment to Incapacitated or Unauthorized Persons

The first paragraph deals with payment to an INCAPACITATED person; the second deals with payment to an UNAUTHORIZED third person.

(2) First Paragraph — Payment to an Incapacitated Person

- (a) Is payment to a person incapacitated to manage or administer his property valid?

ANS.: Such payment is valid only:

- 1) if the incapacitated person has kept the thing delivered; or
- 2) insofar as the payment has been beneficial to him.
(*1st sentence, Art. 1241, Civil Code*).

- (b) *A* owes *B* P1,000,000. When *A* paid *B*, the latter was already insane. However, the money was never spent, and is still in the possession of *B*. Is *A*'s obligation extinguished?

ANS.: Yes, *A*'s obligation is already extinguished by virtue of *A*'s payment to *B*. True, *B* was incapacitated to administer his own property, yet *B* has kept the thing delivered. Hence, *A*'s payment is valid.

- (c) In question (b), suppose that a swindler had asked *B* for P1,000,000 in exchange for a ring worth P500,000, does *A*'s payment to *B* remain valid?

ANS.: *A*'s payment to *B* remains valid only up to the extent of P500,000, because this is only the amount which

B really benefited from *A*'s payment to him. *A*'s payment is thus valid only insofar as the payment has benefited the incapacitated payee.

- (d) Who has the burden of proving that the payment has benefited the incapacitated payee?

ANS.: The one who made the payment has the burden of proving that it benefited the incapacitated payee. (*Panganiban v. Cuevas*, 7 *Phil.* 477). The benefit may be financial, moral or intellectual but it must be proved. (*Ibid.*).

- (e) In proving that the incapacitated payee really benefited from the payment, is it necessary for the payor to prove that the payee invested the thing or money delivered in some profitable enterprise?

ANS.: No, proof of investment is not necessary. All that is needed is proof that payment to the incapacitated payee has in some way or another redounded to the benefit of the payee. After all, this is all that the law requires. (8 *Manresa* 282).

- (f) A good example of beneficial payment to the incapacitated person is when the money has been used for proper hospital or psychiatric expenses.
- (g) If indeed there has been no benefit, what remedy is given?

ANS.: The payment is not valid; therefore, the legal representative of the incapacitated person can demand a new payment on behalf of his ward. The ward himself, should he regain capacity, is allowed to claim a new payment. (8 *Manresa* 279).

(3) Second Paragraph — Payment to a Third Party Not Duly Authorized

- (a) Effect in general of payment to third party: The payment is valid BUT only to the extent of benefit (financial, moral, or intellectual) to the creditor. The payment must be proved (*Panganiban v. Cuevas*, 7 *Phil.* 477), and is, therefore, not presumed except in the three instances provided for in the second paragraph of Art. 1241.

- (b) Examples of when benefit to the creditor is presumed:
- 1) If after payment the third person acquires the creditor's rights;
(Example: An impostor-agent, after payment to him, becomes the owner of the company-creditor.)
 - 2) If the creditor ratifies the payment to the third person;
(Example: If the Meralco, a few days after its unauthorized collector had collected from you, tells you that the payment to him is all right. Here the defect is cured.)
 - 3) If by the creditor's conduct, the debtor has been led to make the payment. (This is a case of *estoppel*, as when the impostor-agent had been given by the Meralco the usual *uniform* for collectors.)
- (c) Rule with reference to checks.

People v. Yabut
L-42847, L-42902, Apr. 29, 1977

Delivery to the messenger of the payee of a check is not yet delivery to the payee within the context of the Negotiable Instruments Law.

(NOTE: This ruling is of doubtful validity because as long as the messenger was duly authorized by the payee, delivery to the messenger [and agent] should be considered as delivery to the payee.)

Art. 1242. Payment made in good faith to any person in possession of the credit shall release the debtor.

COMMENT:

(1) Payment Made in Good Faith to a Person in Possession of the Credit

The Article is *another* instance of a valid payment.

(2) Requisites

- (a) Payment by payor must be made in *good faith* (this is presumed) (but payee may be in *good* or *bad* faith).
- (b) The payee must be in *possession of the credit itself* (not merely the *document* evidencing the credit).

(NOTE: When one possesses the credit, there is *color of title* to it.)

(3) Examples of a Person in Possession of the Credit

- (a) *X* found a negotiable promissory note *payable to bearer*. (If the maker thereof pays in good faith to *X*, the debt is extinguished, even if *X* was not entitled to it.)

HELD: If the promissory note was payable to a specific person *Y*, then payment to *X* is not valid, because *X* would be the possessor only of the document, *not* the credit itself.

- (b) *X*, a presumed heir, entered upon an inheritance, *collected the credits* of the estate, but was later declared by the court to be incapacitated to inherit. (Payment of the credit to *X* extinguished the obligation.)

(4) Case

Sps. Alcaraz v. Tangga-an
GR 128568, Apr. 9, 2003

FACTS: Petitioner-spouses aver that their payments to Virgilio (who supposedly became the new owner of the house after acquiring title to the lot) beginning Nov. 1993 were payments made in good faith to a person in possession of the credit, in consonance with Art. 1242. Payment made in good faith to any person in possession of the credit shall release the debtor. This, petitioner-spouses point out, released them from their obligation. They claim that Virgilio collected the rentals in his capacity as a co-owner, and being a son of Virginia (husband of respondent Pedro *Tangga-an*), he (Virgilio) was also entitled to the rent of the subject house.

HELD: This contention is incorrect. Virgilio collected the rentals not as a co-owner but as the alleged sole owner of the

subject house. Petitioner-spouses themselves admitted that Virgilio claimed sole ownership of the house and lot. It would be incongruous for them to now assert payment in good faith to a person they believed was collecting in behalf of his co-heirs after admitting that they paid rent to Virgilio as the sole owner thereof. Hence, for violating the terms of the lease contract, *i.e.*, payment of rent, respondents can legally demand the ejectment of petitioner-spouses.

(5) Belligerent Occupant

While a belligerent occupant such as the Japanese Armed Forces during the World War II may sequester an enemy's private credit (*Haw Pia v. China Banking Corp.*, 80 Phil. 604 and *Gibbs v. Rodriguez*, 47 O.G. 186), mere attachment of the property, without actual confiscation, does not confer possession upon said belligerent. Such attachment or embargo merely prohibits the owner from disposing thereof. This is *no* segregation or sequestration of the properties; hence, payment to such belligerent, who is *not* in possession of the credit, does not extinguish the obligation, whether payment is made in good faith or not. (*Panganiban v. Cuevas*, 7 Phil. 477).

Panganiban v. Cuevas 7 Phil. 477

FACTS: Panganiban sold *a retro* in 1897 his parcel of land to Gonzales, but subsequently said land was attached by the revolutionary government. Because he was not able to find Gonzales on account of the war, Panganiban in good faith paid the repurchase money to said revolutionary government. Later, Gonzales sold the land to Cuevas. Panganiban then brought this action to get the land from Cuevas.

HELD: The action will not prosper, because payment of the repurchase money to the revolutionary government was not valid. Said government merely attached the properties, merely prohibited its alienation. Therefore, it was *not* in possession of the credit. However, Panganiban can redeem the property from Cuevas by giving him the repurchase money.

Art. 1243. Payment made to the creditor by the debtor after the latter has been judicially ordered to retain the debt shall not be valid.

COMMENT:

(1) Payment Made After Judicial Order to Retain

The judicial order may have been prompted by an order of *attachment, injunction or garnishment* (garnishment takes place when the *debtor of a debtor* is ordered not to pay the latter so that preference would be given to the latter's creditor). Note that the payment in this Article is void.

(2) 'Garnishment' Defined

"The proceeding by which a debtor's creditor is subjected to the payment of his own debt to another is known as garnishment. It consists in the citation of some stranger to the litigation, who is the debtor of one of the parties to the action. By this means such debtor-stranger becomes a forced intervenor, and the court, having acquired jurisdiction over his person by means of the citation required of him to pay his debt, not to his former creditor, but to the new creditor, who is the creditor in the main litigation." (*Tayabas Land Co. v. Charruf*, 41 Phil. 382).

(3) Example of Garnishment

- (a) A owes B P1,000,000. B, in turn, owes C P100,000. C brings an action against B, who, however, claims insolvency but admits the credit which he has over A. Before A pays B, A is summoned into the proceedings, and asked to retain the debt in the meantime. Thus, the debt is "garnished." The reason is A should not pay B, and instead he should pay C, should C really be adjudged the creditor of B. Any payment made by A to B in the meantime is considered invalid under the law.
- (b) Suppose in the preceding example, A and B, in the meantime, deposited the judicial order to the contrary and supposing it should turn out that C is not really the creditor of B as a consequence of which the garnishment proceedings

are dropped, should *A* again pay *B*, in view of the fact that the first payment, strictly speaking, is not valid under the law?

ANS.: It is submitted that *A* need not pay *B* a second time. True, at the beginning the payment was not valid, but the defect here has been cured by the dismissal of the garnishment proceedings. It is as if there never had been any judicial order asking the debtor *A* to retain the debt. Furthermore, why should *B*, the creditor, be paid twice for the same debt? To hold that he should be is to allow a travesty of justice, an undue enrichment of *B*.

- (c) Pending garnishment, may the debtor be judicially ordered to pay the *creditor of his debtor* (such creditor is the garnishing or attaching creditor)?

ANS.: No, because under the Rules of Court the credit must be given to the *clerk, sheriff*, or other proper officer of the court. (*Sec. 8, Rule 57, Revised Rules of Court*).

(4) ‘Interpleader’ Defined

It is technical name of the action in which a certain person in possession of certain property wants claimants to litigate among themselves for the same. The Revised Rules of Court provides: “Whenever conflicting claims upon the same subject matter are or may be made against a person who claims no interest whatever in the subject matter, or an interest which in whole or in part is not disputed by the claimants, he may bring an action against the conflicting claimants to compel them to interplead and litigate their several claims among themselves.” (*Sec. 1, Rule 63*).

(5) Example of Interpleader

A has in his possession some merchandise, to be delivered to the person who presents the proper receipt. *B* and *C*, each armed with a receipt, ask *A* to turn over the property to one of them. An examination of the receipts reveals that they are of exactly the same kind. *A* does not know to whom he should deliver the property. So he files an action in court by means of

which *B* and *C* will be able to settle their conflicting rights. The court must now issue an order prohibiting payment to either *B* and *C* in the meantime. Despite the receipt of the order, *A* pays *B*, who is the brother of his (*A*'s) sweetheart. Is said payment valid? Obviously not. *Reason*: The payment here was made after the debtor had been judicially ordered to retain the debt. *Reason for the law*: Evidently, the debtor here (*A*) cannot say he paid *B* in good faith. He had ulterior motives for his act, otherwise he would not have disobeyed the lawful order of the court. Under the law, therefore, *A* is deemed to be a payor in bad faith.

(6) 'Injunction' Defined

It is a judicial process by virtue of which a person is generally ordered to *refrain* from doing something. It is called preliminary injunction if the prohibition is during the pendency of certain proceedings.

(7) Example of Injunction

A owes *B* a sum of money. When *A* is about to pay *B*, the relatives of the latter move to stop the payment on the ground that *B* appears to be insane. However, proceedings in court to determine *B*'s sanity are still in progress. Seeing *A*'s determination to pay, the relatives of *B* ask the court for a writ of preliminary injunction restraining *A* from paying *B* in the meantime. The injunction is granted. Would it be advisable for *A* to pay *B* despite said injunction?

ANS.: No, it would not be advisable for *A* to pay while he is under injunction; otherwise, his payment will not be valid since this would then be payment made to the creditor by the debtor after the latter has been judicially ordered to retain the debt.

Art. 1244. The debtor of a thing cannot compel the creditor to receive a different one, although the latter may be of the same value as, or more valuable than that which is due.

In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance against the obligee's will.

COMMENT:**(1) Debtor Cannot Compel Creditor to Accept a Different Object**

Example:

A is obliged to give B a *Jaguar* car. Not having any *Jaguar* car, A wants B to accept a *Rolls Royce*, a more expensive car, but B refuses to accept. Is B justified legally in refusing to accept?

ANS.: Yes. Even if the *Rolls Royce* be more valuable than the *Jaguar*, if B does not want the *Rolls Royce*, he cannot be compelled by A to accept it. The terms of the contract form the law between the parties, and the subject matter cannot be changed without the consent of the parties.

Question: Is Art. 1244 of the Civil Code applicable to personal positive and negative obligations?

ANS.: Yes. In obligations to do or not to do, an act or forbearance cannot be substituted by another act or forbearance against the obligee's will. Of course, if the obligee consents, this is all right.

(2) Instances When Art. 1244 Does Not Apply

- (a) in case of *facultative* obligations;
- (b) in case there is another agreement resulting in either:
 - 1) *dation* in payment (*Art. 1245, Civil Code*);
 - 2) or novation (*Art. 1291, Civil Code*);
- (c) in case of waiver by the creditor (expressly or impliedly).

Art. 1245. Dation in payment, whereby property is alienated to the creditor in satisfaction of a debt in money, shall be governed by the law of sales.

COMMENT:**(1) 'Dation in Payment' Defined**

It is that mode of extinguishing an obligation whereby the debtor alienates in favor of the creditor, property for the satisfaction of monetary debt.

(2) Synonyms for Dation in Payment

- (a) *datio in solutum*
- (b) *adjudicacion en pago* (8 Manresa 323)

(3) Examples

- (a) To pay my debt of P1,000,000 in favor of Bella, I gave her *with her consent* a diamond ring instead worth P1,000,000.
- (b) To pay off his debt, an heir assigned his inheritance in an estate to his creditor. (*Ignacio v. Martinez, 33 Phil. 576*).

(4) Reasons Why Dation in Payment Is Governed by the Law of Sales

This is so because *dation* in payment — the transfer or conveyance of ownership of a thing as an accepted equivalent of performance — really partakes in one sense of the nature of sale, *i.e.*, the creditor is really buying some property of the debtor, payment for which is to be charged against the debtor’s debt. However, it may also be called a “novation.” But sales and *novation* require *common consent*.

(5) Sale Distinguished from Dation in Payment

SALE	DATION IN PAYMENT
(a) there is <i>no</i> pre-existing credit	(a) there is a pre-existing credit
(b) this gives <i>rise</i> to obligations	(b) this <i>extinguishes</i> obligations
(c) the cause or consideration here is the PRICE (from the viewpoint of the seller); or the obtaining of the OBJECT (from the viewpoint of the buyer)	(c) the cause or consideration here, from the viewpoint of the debtor in <i>dation</i> in payment is the <i>extinguishment</i> of his <i>debt</i> ; from the viewpoint of the creditor, it is

	the <i>acquisition of the object offered in credit</i>
(d) there is greater freedom in the determination of the price	(d) there is less freedom in determining the price
(e) the giving of the price may generally end the obligation of the buyer	(e) the giving of the object in lieu of the credit may extinguish <i>completely</i> or only <i>partially</i> the credit (depending on the agreement). (8 <i>Manresa</i> 323).

(6) Conditions Under Which a Dation in Payment Would Be Valid

- (a) *If the creditor consents*, for a sale presupposes the consent of both parties.
- (b) *If the dation in payment will not prejudice the other creditors*, for this might lead the debtor to connive with one creditor in defrauding the other creditors.
- (c) *If the debtor is not judicially declared insolvent*, for here his property is supposed to be administered by the assignee.

[NOTE: In *dation*, it is not always necessary that all the property of the debtor will be given to satisfy the credit. (8 *Manresa* 232).]

[NOTE: For the distinction between *cession* (assignment) and *dation*, refer to comments under Art. 1255.]

Art. 1246. When the obligation consists in the delivery of an indeterminate or generic thing, whose quality and circumstances have not been stated, the creditor cannot demand a thing of superior quality. Neither can the debtor deliver a thing of inferior quality. The purpose of the obligation and other circumstances shall be taken into consideration.

COMMENT:**(1) Obligation to Give Generic Things***Reasons for the Article:*

“This Article gives a principle of equity in that it applies justice in a case where there is lack of precise declaration in the obligation. It is always hard to find one thing that is exactly similar to another. But in this kind of obligation, there is the question of relative appreciation in that one party appreciates the same thing as the other party does. If there is disagreement between them, then the court steps in and declares whether the contract has been complied with or not, according to the circumstances.” (8 *Manresa* 280-281).

(2) Waiver

If the contract does not specify the *quality* —

- (a) the creditor cannot demand a thing of superior quality (but if he desires, he may demand and accept one of inferior quality).
- (b) the debtor cannot deliver a thing of inferior quality, but if he so desires, he may deliver one of *superior* quality (provided it is not of a different kind). (*See Art. 1244, Civil Code*).

(3) When Contract Is VOID

Note that the Article speaks of **QUALITY** and other circumstances. When the **KIND** and **QUANTITY** (as distinguished from *quality*) cannot be determined without need of a new agreement of the parties, the contract is *void*. (*Art. 1349 and Art. 1409, No. 6, Civil Code*).

“The object of every contract must be determinate as to its kind. The fact that the *quantity* is *not* determined shall *not* be an obstacle to the existence of the contract provided it is possible to determine the same without the need of a new contract between the parties.”

Art. 1247. Unless it is otherwise stipulated, the extrajudicial expenses required by the payment shall be for the account of the debtor. With regard to judicial costs, the Rules of Court shall govern.

COMMENT:

(1) Debtor Pays Generally for Extrajudicial Expenses

General Rule:

The debtor has to pay for the extrajudicial expenses incurred during the payment. *Reason:* By express provision of law. *Reason for the law:* It is the debtor who benefits primarily, since his obligation is thus extinguished.

Exception: When there is a stipulation to the contrary.

(2) What Governs Judicial Costs?

The Rules of Court, principally Rule 142.

(3) How Judicial Costs Are Determined

Generally, costs shall be awarded to the winning party. But this is subject to the discretion of the court. “Unless otherwise provided in these rules, costs shall be allowed to the *prevailing party* as a matter of course, but the court shall have power, for *special reasons*, to adjudge that either party shall pay the costs of an action, or that the same be divided, as may be equitable.” (*Sec. 1, Rule 142, Revised Rules of Court*).

(4) Generally No Costs Against the Government

“No costs shall be allowed against the Republic of the Philippines, unless otherwise provided by law.” (*Sec. 1, last sentence, Rule 142, Revised Rules of Court*).

Art. 1248. Unless there is an express stipulation to that effect, the creditor cannot be compelled partially to receive the prestations in which the obligation consists. Neither may the debtor be required to make partial payments.

However, when the debt is in part liquidated and in part unliquidated, the creditor may demand and the debtor may effect the payment of the former without waiting for the liquidation of the latter.

COMMENT:

(1) Performance Should Generally Be Complete

Under Art. 1233 of the Civil Code, a debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been *completely* delivered or rendered, as the case may be. Hence, partial performance is not allowed generally under Art. 1248.

(2) Exceptions

Partial performance is allowed:

- (a) When there is stipulation to this effect;
- (b) When the different prestations are subject to different conditions or different terms;

(Example: a debt payable in installments)

- (c) When a debt is in part liquidated and in part unliquidated, in which case performance of the liquidated part may be insisted upon either by the debtor or the creditor;

(Example: D owes C P3 million plus damages. Even if the amount of damages has not yet been ascertained, the P3 million is already known or liquidated. This is already demandable and payable.)

- (d) When a *joint debtor* pays his share or the creditor demands the same;

(NOTE: This is a complete payment of his share, but it is still a partial fulfillment of the whole obligation.)

- (e) When a *solidary debtor* pays only the part demandable because the rest are not yet demandable on account of their being subject to different terms and conditions;
- (f) In case of compensation, when one debt is larger than the other, it follows that a balance is left (*See Art. 1290, Civil Code*);

- (g) When work is to be done by parts. (*See Art. 1720, Civil Code*).

[NOTE: In criminal law, the Supreme Court has held that the acceptance of partial payment by an offended party is not one of the means of extinguishing criminal liability. The reason is: A criminal offense is committed against the people, and the offended party may *not* waive or extinguish the criminal liability that the law imposes for the commission of the offense. (*Camus v. Court of Appeals, et al.*, 48 O.G. 3898 {1956}.)

Art. 1249. The payment of debts in money shall be made in the currency stipulated, and if it is not possible to deliver such currency, then in the currency which is legal tender in the Philippines.

The delivery of promissory notes payable to order, or bills of exchange or other mercantile documents shall produce the effect of payment only when they have been cashed, or when through the fault of the creditor they have been impaired.

In the meantime, the action derived from the original obligation shall be held in abeyance.

COMMENT:

(1) ‘Legal Tender’ Defined

It is that which a debtor may compel a creditor to accept in payment of the debt (whether *public* or *private*).

(2) Legal Tender in the Philippines

- (a) Before the advent of Martial Law, all *notes* and *coins* were issued by the Central Bank (now Bangko Sentral) (without a maximum limit). (Sec. 54, RA 265).
- (b) Under Sec. 231 of Presidential Decree 72 (Amending RA 265, the “Central Bank Act”), of Martial Law, and effective Nov. 29, 1972, the 1 centavo coin and the 5- centavo coin are valid legal tender up to P20.00; the other coins (10, 25, 50, and P1) are valid legal tender up to P50; and all bills are valid legal tender for *any* amount.

[NOTE: During the Japanese occupation, the following were held to be legal tender:

- (a) Japanese military notes. (*Haw Pia v. China Banking Corp.*, 80 Phil. 604).
- (b) “Emergency notes” authorized and issued by the Commonwealth Government, but these ceased to be legal tender after Exec. Order 25 dated and effective Nov. 18, 1944. (*Mondejar v. Nicolo*, {C.A.} 43 O.G. 5099).]

[NOTE: Registration and redemption of “guerilla notes” are governed by RA’s 22 and 369, respectively.]

[NOTE: Under the old law, Rep. Act 897, the acceptance of backpay certificates in payment of loans to government corporations was indeed obligatory upon the Philippine National Bank (PNB). However, the enactment of Rep. Act 1576, dated Jun. 16, 1956, which adds a new provision, Section 9-a, to the Revised Charter of the PNB, removes this obligation imposed upon the said bank. (*Phil. Nat. Bank v. Ereneta*, L-13058, Aug. 28, 1959).]

(3) Doctrines for Transactions During the Japanese Occupation

- (a) Payment of debts (pre-war and Japanese occupation debts) made and due during the Japanese occupation was valid because the Japanese notes *were* legal tender, so with all transactions that did *not* partake of a political complexion, unless there was some other defect. (*Haw Pia v. China Banking Corporation*, 80 Phil. 604; *Co Kim Cham v. Tan Keh*, GR L-5, S.C., Sept. 17, 1945; *Orden de P.P. Benedictos v. Phil. Trust Co.*, 47 O.G. No. 2894; and *Filipinas Life Assurance Co. v. Nava*, L-20552, May 20, 1966).
- (b) But if the debt was not due and payable *during* the Japanese occupation, payment thereof was VOID. (*Garcia v. De los Santos*, 49 O.G. 48 and *Nicolas v. Matias*, L-1743).
- (c) Bank deposits during the occupation were not valid, but withdrawals *were valid and deductible*, except insofar as said withdrawal could be deducted from prior deposits of Japanese money. (*Ex. Order 49, the Lowest Minimum Balance or Credit Law*). The rule applies, whether the deposit

was in the form of cash or check. (*Yek Tang Lin Fire and Marine Insurance Co. v. PNB, L-14271, Apr. 29, 1960*). (*Hilado v. De la Costa, 83 Phil. 471*, says the technical reason being that a *bank deposit* is not a payment of any obligation, whereas a *bank withdrawal* is a payment of the loan contracted by the bank.) Moreover, one important reason why in general the bank deposits were held void was that banks are, ordinarily, obliged to receive deposits. There is a sort of *compulsion*. Hence, Ex. Order 49 had to be issued in the exercise of the police power of the state. (*Feliciano Cruz v. Aud. Gen., L-12233, May 30, 1959*).

Example of General Rule:

P1,000	—	(pre-war deposit)
300	—	(1942 withdrawal)
100	—	(1943 withdrawal)
350	—	(1944 deposit)
P600	(balance — because the withdrawals must be subtracted while the deposit will <i>not</i> be added)	

Example of the Exception:

P1,000	—	(pre-war deposit)
350	—	(1942 withdrawal)
300	—	(1943 withdrawal)
100	—	(1944 withdrawal)
P950	(Reason: The P300 withdrawal can be subtracted from the deposit of P350 because said deposit was <i>made use of</i> , leaving P50 extra deposit. The second withdrawal of P100 can be charged to the remaining P50 and to the original account of P1,000 — leaving P950).	

**Feliciano A. Cruz v. Auditor General
L-12233, May 30, 1959**

FACTS: During the Japanese occupation, Cruz wanted to purchase a lot made available to the public by the government

(Rural Prog. Adm.). The lot was the Sta. Clara Estate in Sampaloc, Manila. Pursuant to government requisites, Cruz has to pay P1,160 in Japanese money as “*deposit*.” After liberation, he sought the delivery to him of the lot. In the meantime, he was required to pay the WHOLE purchase price. He now sues for the value paid during the Japanese occupation. The Aud. Gen. refused on two grounds: Firstly, under Ex. Order No. 49, “deposits” were considered void. Secondly, the loss of the “deposits” by a fortuitous event must be borne by the depositor.

HELD: Cruz can recover for what he gave was not really a deposit (a *real* contract), but an advance payment. Moreover, Ex. Order 49, which speaks of “bank deposits” applies merely to *banks*, who were then under a sort of compulsion to accept “deposits.” Here, the Rural Progress Adm. was under *no* compulsion. If at all, it was Cruz who was compelled to pay the deposit required. Cruz, however, should be credited only with the value in the Ballantyne Scale, as the deposit could have been returned during the war.

(d) *When the Ballantyne Scale should be or should not be used:*

- 1) If the debt was contracted during the occupation and was payable ON DEMAND, but not yet paid when liberation came, get the VALUE of the debt —
 - a) according to *actual exchange rate* at the time it was due, between genuine currency and the Japanese notes (*Abendano v. Hao Su Ton*, [CA] 47 O.G. 6359 and *Barcelon v. Arambulo*, [CA] 48 O.G. 3976);
 - b) or if such actual exchange rate could not be proved, according to the Ballantyne Scale. (*Wilson v. Berkenkotter*, 92 Phil. 918; *Soriano v. Abalos*, 84 Phil. 206 and *Gomez v. Tabia*, 84 Phil. 269).
- 2) If the debt was contracted during the Japanese occupation and was payable DURING the occupation (*same as No. 1*). (*Fernandez, et al. v. Nat. Ins. Co.*, GR L-9416, Jan. 27, 1959).

[NOTE: If a check received as payment was dated Jan. 5, 1945 (Japanese occupation period) but

was *presented* for payment only on Nov. 15, 1954 (post-liberation period), the check must be paid in accordance with the Ballantyne schedule of values, for after all, it was payable during the Japanese occupation. (*Garcia v. PNB, L-14996, May 31, 1961*).]

- 3) If the debt was contracted during the Japanese occupation and was payable EITHER DURING *the occupation* or AFTER *liberation* (same as No. 1).

[*Example:*

D borrowed from *C* P1,000 in 1942, and he promised to pay it *on or before* Jan. 8, 1952. Here it is clear that the *benefit* of the term is given to *D*, therefore he could have paid it *during* the occupation or *after* liberation (1945). Therefore, the rules given above can apply. (See *Mercado v. Mercado, L-14461, Aug. 29, 1960*; see also *Aguilar v. Miranda, L-16510, Nov. 29, 1961* and *Server v. Car, L-22676, Nov. 23, 1966*).]

- 4) If the debt was contracted during the occupation but was payable only AFTER liberation (*Example:* “*pay in 1974*”), *genuine Philippine currency* MUST BE PAID (not the equivalent actual exchange rate NOR in accordance with the Ballantyne Scale). (*Wilson v. Berkenkotter, 92 Phil. 918*; *Ponce de Leon v. Syjuco, Inc., 90 Phil. 311*; *Rono v. Gomez, 83 Phil. 890*; *Garcia v. De los Santos, 93 Phil. 683*; *Kare and Bausa v. Imperial, et al., L-7906 and L-10176, Oct. 22, 1957*; *Fong v. Javier, L-11059, Mar. 25, 1960*; *Dizon v. Arastria, L-15383, Nov. 29, 1961*; *Aguilar v. Miranda, L-16510, Nov. 29, 1961* and *Server v. Car, L-22676, Nov. 23, 1966*).

(NOTE: In the case of *Sternberg and Sternberg v. Soloman, L-10691, Jan. 31, 1958*, it was held that where the deed of mortgage dated Aug. 7, 1944 provided that the obligation secured thereby shall be paid one year from the date thereof, or on Aug. 7, 1945, “and expressly agreed not sooner,” it is understood that the same was payable *only after liberation* and, therefore, must be paid in *Philippine currency on the peso-to-peso basis*.)

(NOTE: In the case of *Kare & Bausa v. Imperial, et al.*, L-7906 and L-10176, Oct. 22, 1957, the Court said that one of the reasons for that ruling is that the parties in stipulating to have the monetary obligation discharged not before but after the termination of the war, intended to have the said obligation paid, *not* in Japanese war notes nor their value, but in Philippine currency.

Incidentally too, in said case, where the parties agreed that payment would be made not sooner than six months nor later than eighteen months after the “termination of the Greater East Asia war,” the court held that the termination of such war is to be based on its legal meaning or *legal sense*, namely, the *official proclamation* which was made on Dec. 31, 1946.)

[NOTE: Where under the contract, the vendors were allowed to exercise *their right to repurchase* within the period of 10 years from the day of execution (Feb. 22, 1944) on condition that they may exercise their right only *after* the expiration of the first five years, this right became vested only after the liberation of the Philippines. Hence, payment can only be effected in accordance with the present currency. (*Ceyras, et al. v. Ulanday, L-12700, Jun. 29, 1959*).]

Value of One Peso (P1.00) of Philippine Currency in Terms of Japanese Military Notes Issued in the Philippines

MONTHS	1942	1943	1944	1945
January	1.00	1.05	4.00	12.00
February	1.00	1.10	5.00	NONE
March	1.00	1.15	6.00	
April1.00	1.20	9.00		
May1.00	1.25	12.00		
June1.00	1.30	15.00		
July1.00	1.40	20.00		
August	1.00	1.50	25.00	
September	1.00	1.60	30.00	
October	1.00	1.70	40.00	
November	1.00	1.80	60.00	
December	1.00	2.50	90.00	

[This scale was taken from the Bill sent by President Osmeña to Congress on December 13, 1945. Mr. Ballantyne was a Special Bank Adviser to the President. Unfortunately, the Bill, although approved by Congress of the Philippines, was not approved by the President of the United States to which it had been sent for approval. Nevertheless, the Ballantyne Scale has been applied in several instances both by the Philippine Supreme Court, and by the Philippine Court of Appeals. The Scale is now a matter that comes within judicial notice, inasmuch as it has now become part of our jurisprudence. So, even if not set up as a defense or proved, it may be considered. (*Lopez v. Ochoa*, L-7955, May 30, 1958).]

(4) Illustrative Cases

Allison J. Gibbs, etc. v. Eulogio Rodriguez, Sr., etc.

L-1494, Aug. 3, 1949

(Validity of Japanese Transactions)

FACTS: A mortgaged two parcels of land to *B*, an American company in the Philippines. *A* assigned, with the consent of *B*, his (*A*'s) rights to *C*. During the Japanese occupation, *C* paid off the mortgage to the Department of Enemy Property established by the Japanese Military Administration. The Register of Deeds then cancelled the mortgage. Now *B* brings this action against *C* for the amount of the mortgage, and against the Register of Deeds for the restoration of the mortgage. *Issue:* Was the payment by *C* to the Bureau of Enemy Property valid?

HELD: The question involved in the instant case is whether or not the payment of the mortgage deed to the Bureau of Enemy Property is valid. In the *Haw Pia* Case, the court held that such collection of credit was not a confiscation but a sequestration of the enemy private properties and, therefore, the payment by *Haw Pia* to the Bank of Taiwan was valid and released plaintiff's obligation to the defendant Bank. In the present case, the issue is similar. Therefore, the decision should be the same, that is, *C* has already paid off the mortgage, and the Register of Deeds acted legally when he cancelled the mortgage. Hence, *B* cannot recover anything from *C*.

**Domingo Aurreocoecha v.
Kabankalan Sugar Co., Inc.
81 Phil. 476
(Defense of Alleged Duress)**

FACTS: Plaintiff had a deposit account with the defendant corporation. On *October 12, 1941*, plaintiff notified the defendant of his (the plaintiff's) intention to withdraw all his deposits. Because of the outbreak of the war, it was only on April 18, 1943 that the defendant acted on the plaintiff's application for withdrawal. On said date, the plaintiff received his balance, amounting to P55,957.75. The following day, the plaintiff deposited said amount with the Philippine National Bank. By liberation time, plaintiff did not have anymore money. Plaintiff brought this action to recover from the defendant corporation the amount of P55,957.75 on the ground that he accepted the money under duress because he was afraid that if he refused, he would be taken to Fort Santiago. *Issue:* Was the payment to plaintiff in Japanese war notes valid such that the defendant corporation has extinguished its obligation?

HELD: Yes. Payment of pre-war debts in Japanese money during the occupation is, as a general rule, valid. The supposed threat or duress here was certainly not one to inspire genuine fear in a man of the plaintiff's position. And even if the payment in Japanese money did not extinguish the obligation still his subsequent act of making use of the money ratified the payment. Granting that he was threatened into accepting the money, he was not in any way compelled to spend said money.

**Philippine Trust Co. v. Luis Ma. Araneta, et al.
83 Phil. 132
(No Collective or General Duress)**

FACTS: Before the war, Araneta owed the Philippine Trust Co. the sum of P3,683.60, secured by some certificate of stock. On May 2, 1944 the Company made a demand on Araneta. Araneta paid, but the certificates of stocks pledged could not be given because according to the Company, they had been turned over to the U.S. for safekeeping during the war. After liberation, Araneta asked the company for the return of the certificates of stocks, but the company refused to do so on the ground that payment in Japanese war notes was not valid because of *collective* or *general duress*.

HELD: In the *Haw Pia* case, note that under the rules of Public International Law, the right of the military occupant in the exercise of his governmental power to order the liquidation of enemy banks and the reopening of others in the occupied territory, as well as to issue military currency as legal tender, has been conceded.

It is evident that the payment made by the respondent (Araneta) and accepted by the petitioner (Philippine Trust Co.) during the Japanese occupation in compliance with the said orders of the Japanese military occupant, cannot be considered as made under a collective and general duress, because an act done pursuant to the laws or orders of competent authorities can never be regarded as executed involuntarily or under duress of illegitimate constraint of compulsion that invalidates the act."

De Asis v. Buenviaje, et al.
45 O.G. No. 1, p. 317
(Seller Benefited with Use of Japanese Money)

FACTS: A sold B some properties during the Japanese occupation. A received war notes as payment. After liberation, A sought to recover the properties on ground that the money paid to him was worthless. *Issue:* Is A correct?

HELD: A is not correct. Because A willingly sold said properties and *benefited with the use of the purchase money*, he cannot now, on the ground, attack the validity of the sale. "The Japanese war notes were *legal tender* during the occupation and in Mar. 1943, when the sale in question was made, they were at par with Philippine currency. Those who sold their properties then and voluntarily accepted said notes in payment therefor have to suffer the consequences when the notes depreciated in value or became worthless."

Mondejar v. Nicolo
43 O.G. No. 12, p. 5099
(When "Emergency Notes" Ceased to Be Legal Tender)

FACTS: A was a sub-lessor, and B, a sub-lessee. In payment of rentals, B was paying A "emergency notes" but since A did not want to accept, B deposited the money with the Municipal

Treasurer's Office on Apr. 7, 1945. It was proved, however, that on said date, the "emergency notes" were no longer legal tender. *Issue*: Was the deposit in the office equivalent to payment?

HELD: No, said deposit was not equivalent to payment because at that time, the "emergency notes" were no longer legal tender. They were good only up to Nov. 18, 1944 by virtue of Ex. Order 25.

**Fernandez, et al. v.
Nat. Insurance Co. of the Philippines
L-9146, Jan. 27, 1957**

FACTS: Juan Fernandez' life was insured on July 15, 1944. He died on Nov. 2, 1944. In 1952, the beneficiaries claim the indemnity. On Jul. 9, 1954, proof of death was approved by the company. Under the Insurance Law, a life insurance policy, in the absence of a definite period, matures upon DEATH, and payment of indemnity must be made within 60 days from proof of death. *Issue*: When did the obligation of the insurance company to pay the indemnity accrue: in 1944 (death) or in 1954 (approval of proof of death)? If in 1944, the Ballantyne scale can be used, for it can be said that the obligation arose during the Japanese occupation; if in 1954, the Ballantyne scale cannot obviously be used.

HELD: The obligation accrued in 1944 when the insured died, hence the Ballantyne scale can be used. The sixty-day period fixed in the Insurance Law is merely *procedural* in nature; it is the death that matures the policy.

(5) Stipulation of Another Currency

- (a) Under the first paragraph of Art. 1249, payment may be either:
 - 1) in the *currency stipulated*;
 - 2) or if it is not possible to deliver such currency, then in *Philippine legal tender*.
- (b) Said first paragraph of Art. 1249 has already been *modified* by RA 529.

Under the said Act, obligations incurred AFTER Rep. Act 529 (Jun. 16, 1950), which are for the purpose of payment in:

- 1) a *foreign* currency
 - 2) an amount of Philippine money to be *measured* by *gold or foreign currency*, should be null, void and of no effect.
- (c) Rep. Act 529, in connection with Art. 1249 of the Civil Code, has been discussed by the Supreme Court in the following cases, among others:
- 1) *Eastboard Navigation Co. v. Ysmael and Co.*, L-9090, Sept. 10, 1957.
 - 2) *Arrieta v. National Rice and Corn Corp.*, L-15645, Jan. 31, 1964.

Thus, the Court has ruled that if the debtor promises to pay in a currency *other than* Philippine legal tender, the stipulation with respect to the currency is VOID. All that the creditor can demand is payment in Philippine legal tender measured at the exchange rate prevailing *not* at the time of payment, but at the time of *contracting or incurring* the debt. (See *Arrieta v. National Rice and Corn Corp.*, L-15645, Jan. 31, 1964).

- (d) However, RA 529 has in turn been amended by RA 4100, which took effect on Jun. 19, 1964.

**Phoenix Assurance Company v.
Macondray and Co., Inc.
L-25048, May 13, 1975**

ISSUE: If a court judgment states that an amount in *dollars* is supposed to be paid the winning party, what table of conversion (of exchange rates) must be used — that at the time the contract was *entered* into, that at the time of *judgment*, or that at the time *payment or satisfaction of the judgment* is made?

HELD: The conversion rate at the time of *payment or satisfaction of the judgment*. If said time of payment or

satisfaction is disputed, the trial court will determine when said payment or satisfaction was made.

[NOTE: Under RA 4100 which took effect on Jun. 19, 1964 and which amended Republic Act 529 — which in turn had modified Art. 1249 of the Civil Code — in “import-export and other international banking, financial investment and industrial transactions” the parties’ agreement as to currency in which an obligation will be paid is BINDING.] (This was a NOTE in the *Phoenix* case.)

[NOTE: Before the effectivity of RA 4100, the applicable rule was RA 529 which generally prohibited transactions in foreign currency, including dollars. This is why in *Arrieta v. National Rice & Corn Corporation, L-15645, Jan. 31, 1964, 62 O.G. 9810, 10 SCRA 79, 88*, an award of damages amounting to \$286,000 was made payable in Philippine pesos, according to the prevailing rate of exchange on Jul. 1, 1952, when the contract was executed (not when the contract was satisfied). The payment in dollars being void, payment must be made in pesos, understood to be at the conversion rate when the contract was entered into, not when the amount is paid or satisfied.]

Zagala v. Jimenez
GR 33050, Jul. 23, 1987

A judgment awarding an amount in U.S. dollars may be paid with its equivalent amount in local currency in the conversion rate prevailing at the time of payment. If the parties cannot agree on the same, the trial court should determine such conversion rate. Needless to say, the judgment debtor may simply satisfy said award by paying in full the amount in U.S. dollars.

If the plaintiff files a motion to fix the peso value of the judgment in dollars, they only intend to exercise the right granted to them by the present jurisprudence — that the trial court shall determine or fix the conversion rate prevailing at the time of payment, and it is error for the trial court to deny said motion.

(6) Uniform Currency Law**C.F. Sharp & Co. v. Northwest Airlines
GR 133498, Apr. 18, 2002**

The repeal of RA 529 by RA 8183 has the effect of removing the prohibition on the stipulation of currency other than Philippine currency, such that obligations or transactions may now be paid in the currency agreed upon by the parties.

Just like RA 529, however, the new law does not provide for the applicable rate of exchange for the conversion of foreign currency-incurred equivalent. It follows, therefore, that the jurisprudence established in RA 529 regarding the rate of conversion remains applicable.

Obligations in foreign currency may be discharged in Philippine currency based on the prevailing rate at the time of payment. The wisdom on which the jurisprudence interpreting RA 529 is based equally holds true with RA 8183. Verily, it is just and fair to preserve the real value of the foreign exchange-incurred obligation to the date of its payment.

(7) Bar

In a 10-year lease of a store space on the *Escolta* to be dated today, may the parties stipulate that the rental shall be for every month, the equivalent rent in pesos, during the preceding month, of \$500? Briefly explain your answer.

ANS.: The parties to the lease are not allowed to stipulate that the rental, although payable in pesos, shall be the equivalent of \$500 because under RA 529, such a provision is considered null and void, if the same was agreed upon after said Act, which amended Art. 1249 of the new Civil Code, became effective. Sec. 1 of said Act states: "Every provision contained in . . . any obligation which provision purports to give the obligee the right to require payment in *gold* or in a *particular* kind of coin or currency *other* than the Philippine currency, or *in an amount of money of the Philippines measured thereby*, shall be as it is hereby declared *against public policy, null and void and of no effect*, and no such provision shall be contained in, or made with respect to, any obligation hereinafter incurred."

[NOTE: Rules for obligations incurred *PRIOR* to Rep. Act 529 and payable in a *FOREIGN CURRENCY*:

- (a) If it was an obligation (which was NOT a loan), payment should be made in *Philippine currency* at the rate of exchange prevailing at the time the obligation was INCURRED.
- b) If it was a LOAN, payment should also be in Philippine currency at the rate of exchange prevailing at the time of the *stipulated* date of payment. (RA 529). Hence, a letter of credit for \$14,000 obtained on or before 1949 must be paid in Philippine currency at the rate of P2 for \$1 instead of P2.41 for every dollar, since RA 529 cannot impair obligations incurred prior to its effectivity in 1951. (*PNB v. Zulueta*, L-7271, Aug. 30, 1957 reiterated in *PNB v. Union Books*, L-8490, Aug. 30, 1957). (In said cases, the court held that whether payable in dollars or in the equivalent of dollars in Philippine currency, the same principle would apply.)]

[NOTE: It has also been held that a debtor cannot be required to pay the foreign exchange tax, imposed by law after the obligation was constituted, for remitting the payment to the creditor abroad in dollars. (*Eastboard Navigation v. Ysmael*, L-9090, Sept. 10, 1957).]

(8) Delivery of Commercial Instruments

- (a) A check is *not* legal tender and, therefore, the creditor cannot be compelled to accept payment thru this means. (*Belisario v. Natividad*, 60 Phil. 156 and *Villanueva v. Santos*, 67 Phil. 648). The rule applies even when payment is made thru consignation in court. (*Villanueva v. Santos*, 67 Phil. 648).
- (b) Even a *bank manager's check* is not legal tender. (*Cuaycong v. Rius*, 47 O.G. No. 6125).
- (c) Instances when a check or a commercial document should be accepted as payment:
 - 1) when the creditor is in *estoppel* or he had previously promised he would accept a check;

- 2) when the check has lost its value because of the fault of the creditor (*Art. 1249, 2nd par.*), as when he has unreasonably delayed in presenting the check for payment (*Phil. Nat. Bank v. Seeto, L-4388, Aug. 13, 1952*), or when, in the case of a foreign bill of exchange, the creditor neglects to make a protest (*Quiros v. Tan Guinlay, 5 Phil. 675*);
- 3) when payment occurs not because of a debt but because of the exercise of the right of *conventional redemption*, since this right is a right, and not a duty, particularly when the check is in fact deposited by the clerk of court with the bank, and the vendee *a retro* has petitioned the court that he be allowed to withdraw the amount of the deposit. (*Cordero v. Siosoco, 41 O.G. No. 4644*).

(d) *Problem*

In payment of his debt, *D* paid *C* a promissory note payable to *C*'s order. *C* accepted the promissory note. Does this mean that the payment has been effected?

ANS.: Not yet. The effect of payment *in this case* will be produced only when the note has been *cashed*; and also, even if it cannot be cashed because of the creditor's fault. (*Art. 1249, par. 2, Civil Code*).

(e) *Problem*

D in payment of a debt, paid *C*, with *C*'s consent, a promissory note payable two months later. During the intervening period, may *C* bring an action to recover from *D*?

ANS.: No, for under the law, pending the cashing of the mercantile document, "the action derived from the original obligation shall be held in abeyance." (*Art. 1249, last sentence, Civil Code*).

Quiros v. Tan Guinlay
5 Phil. 675

FACTS: A was in possession of a bill of exchange endorsed to him or his order. In payment of merchandise, A indorsed the

bill of exchange to *B* who willingly accepted it. When *B* presented the bill of exchange to the bank, the bank refused to pay, on the ground that the supposed acceptance (written on the bill) by the bank was a forgery. *B* did not make a protest and in the course of time, the bill lost completely its value. Later *B* sued *A* for the price of the merchandise. *Issue*: Can *B* recover?

HELD: No, *B* cannot recover from *A*. By reason of the neglect of *B*, the creditor, the value of the bill has been impaired. *B* cannot blame *A*, and, therefore, the delivery of the bill by *A* to *B* operated as complete payment for the merchandise.

(9) Postdated Checks

Ongsip v. Prudential Bank GR 27328, May 30, 1983

A postdated check is not a check at all, and a bank is not allowed to deduct from a depositor's current account the postdated check issued by the depositor.

Art. 1250. In case an extraordinary inflation or deflation of the currency stipulated should supervene, the value of the currency at the time of the establishment of the obligation shall be the basis of payment, unless there is an agreement to the contrary.

COMMENT:

(1) 'Inflation' Defined

It is a sharp sudden increase of money or credit or both without a corresponding increase in business transaction. (*Webster's Dictionary*). Since the value of money here tends to decrease, the natural result is an *increase in the price of goods and services*.

(2) 'Deflation' Defined

It is the opposite of inflation.

(3) Non-applicability of the Article Today

The Article speaks of the inflation or deflation of “the currency stipulated,” meaning, the currency OTHER THAN Philippine legal tender as allowed under Art. 1249. But since today, no foreign currency can be stipulated under RA 529, it follows that literally construed, Art. 1250 cannot be made use of for the present. By analogy or extension, however, *it may be possible* to include the extraordinary inflation or deflation of the *Philippine currency*. Today, however, it is doubtful whether what we are experiencing today may already be classed in the category of “extraordinary.”

**Evelyn J. Sangrador, Joined by her husband
Rodrigo Sangrador, Jr.
v. Spouses Francisco Valderrama
and Teresita M. Valderrama
GR 79552, Nov. 29, 1988**

Since petitioners failed to prove the supervening of extraordinary inflation between Apr. 6, 1984 and Dec. 7, 1984 — no proofs were presented on how much, for instance, the price index of goods and services had risen, during the intervening period — an extraordinary inflation cannot be assumed; consequently, there is no reason or basis, legal or factual, for adjusting the value of the Philippine peso in the settlement of respondents’ obligation.

**Filipino Pipe and Foundry Corp. v.
National Waterworks and
Sewerage Authority
GR 43446, May 3, 1988**

Extraordinary inflation exists when “there is a decrease or increase in the purchasing power of the Philippine currency which is unusual or beyond the common fluctuation in the value of said currency, and such decrease or increase could not have been reasonably foreseen or was manifestly beyond the contemplation of the parties at the time of the establishment of the obligation.”

An example of extraordinary inflation is the following description of what happened to the deutschemark in 1920: "More recently, in the 1920's Germany experienced a case of hyperinflation. In early 1921, the value of the German mark was 4.2 to the U.S. dollar. By May of the same year it had stumbled to 62 to the U.S. dollar. And as the prices went up rapidly, so that by Oct. 1923, it had reached 4.2 trillion to the U.S. dollar!" As reported, "prices were going up every week, then every day, then every hour. Women were paid several times a day so that they could rush out and exchange their money for something of value before what little purchasing power was let dissolved in their hands. Some workers tried to beat the constantly rising prices by throwing their money out of the windows to their waiting wives, who would rush to unload the nearly worthless paper. A postage stamp cost millions of marks and a loaf of bread billions."

While there has been a decline in the purchasing power of the Philippine peso, this downward fall of the currency cannot be considered "extraordinary." It is simply a universal trend that has not spared our country.

(4) Basis for Payment

Under this Article, the basis for payment is the value (the real value or worth) at the time the obligation was constituted or incurred, unless there is an agreement to the contrary.

Pan American v. PAA Employees L-18345, Jan. 30, 1964

The purchasing power or value of money or currency does not lawfully depend upon, cannot lawfully come into being, be created, or brought about by, a law enacted by Congress. If by *law* or *treaty* the rate of exchange between two currencies should be fixed or stipulated, such law or treaty could not give the money or currency the purchasing power or value fixed or stipulated, but would bind the Government enacting the law or the contracting parties to a treaty to pay or supply the *difference* between the value fixed or stipulated and the real value of the currency should the latter be lower than the fixed or stipulated rate of exchange between the two currencies.

**Commissioner of Public Highways v.
Hon. Burgos, et al.
L-36706, Mar. 31, 1980**

Art. 1250 applies only to cases where a contract or agreement is involved. It does not apply where the obligation to pay arises from law, independent of contracts. The taking of private property by the Government in the exercise of its power of eminent domain does not give rise to a contractual obligation. Under the law, in the absence of any agreement to the contrary, even assuming that there has been an extraordinary inflation within the meaning of Art. 1250, the value of the peso at the time of the establishment of the obligation, which in the instant case is when the property was taken possession of by the Government, must be considered for the purpose of determining just compensation.

Obviously, there can be no agreement to the contrary to speak of because the obligation of the Government sought to be enforced in the present action does not originate from a contract, but from law which, generally, is not subject to the will of the parties. And there being no other legal provision cited which would justify a departure from the rule that just compensation is determined on the basis of the value of the property at the time of the taking thereof in expropriation by the Government, the value of the property as it is when the Government took possession of the land in question, not the increased value resulting from the passage of time which invariably brings unearned increment to landed properties, represents the true value to be paid as just compensation for the property taken.

Moreover, the law clearly provides that the value of the currency at the time of the establishment of the obligation shall be the basis of payment which, in cases of expropriation, would be the value of the peso at the time of the taking of the property when the obligation of the Government to pay arises. It is only when there is an agreement to the contrary that the extraordinary inflation will make the value of the currency at the time of payment, not at the time of the establishment of the obligation, the basis for payment.

In other words, an agreement is needed for the effects of an extraordinary inflation to be taken into account to alter the

value of the currency at the time of the establishment of the obligation which, as a rule, is always the determinative element, to be varied by agreement that would find reason only in the supervision of extraordinary inflation or deflation.

Acting Chief Justice Claudio Teehankee (concurring): The applicability or non-applicability of Art. 1250 should be taken as *obiter dicta*, since said article may not be invoked nor applied, without a proper declaration of extraordinary inflation or deflation of currency by the competent authorities. The Court has, thus, set aside respondent judge's raising of the amount of compensation for the land from P14,615.79 (at P2.37 per square meter) as properly determined to be its value at the time of its taking in 1924 to P49,459.34 purportedly because of the deflated value of the peso in relation to the dollar.

Art. 1251. Payment shall be made in the place designated in the obligation.

There being no express stipulation and if the undertaking is to deliver a determinate thing, the payment shall be made wherever the thing might be at the moment the obligation was constituted.

In any other case the place of payment shall be the domicile of the debtor.

If the debtor changes his domicile in bad faith or after he has incurred in delay, the additional expenses shall be borne by him.

These provisions are without prejudice to venue under the Rules of Court.

COMMENT:

(1) Where Payment Must Be Made

- (a) If there is a stipulation — in the place DESIGNATED
- (b) If there is *no* stipulation
 - 1) If it is an obligation to deliver a *determinate specific* thing, then in the place where the thing might be (*usually or habitually*) at the time the obligation

was CONSTITUTED. (If merely *temporarily* there, as when the object is being *shipped* or is already in the ocean, payment should be at the *domicile* of the debtor.)

- 2) If the obligation is any other thing (as when it is to deliver a *generic thing*, or to give money, or a *personal obligation*), delivery must be made at the *domicile* of the debtor.

(2) Examples

Ordinarily, a tenant of a house has the right to wait for the landlord in the house since this is an obligation to pay money (a generic thing). (*Manalac v. Garcia*, 76 Phil. 216; *Gomez v. Ng Fat*, 76 Phil. 555). Similarly, a judgment debtor has to pay only at his domicile, in the absence of a specification in the court decree. (*Eastboard Navigation v. Ysmael*, L-9090, Sept. 10, 1957). Payment not at the designated place but only to the mere depository of the creditor's funds is not considered as valid. So if Iloilo was designated, but tender is made in Manila, the payment is not generally to be made at the latter place. (*Gonzaga & Hernandez v. Rehabilitation Finance Corp.*, L-8947, Feb. 10, 1957).

(3) Illustrative Cases

Manalac v. Garcia 76 Phil. 216

FACTS: *A* rented a house from *B*. Although there was no need to do so, it was expressly agreed that payment of the rental should be made at the domicile of the lessee *A*. When the time for payment came, *A* waited at the house for a receipt to be presented to him. But *B* delayed several months, on the ground that *A* should have gone to *B* (and not *B* to *A*). **Issue:** Is *A* in default?

HELD: No, *A* is not in default. He was justified in waiting for the receipt at the house he was renting. *Said the Supreme Court:* "The payment of the rental having been agreed to be made at the domicile of the debtor, he had a right to wait that

the receipt be presented to him and he does not incur default for the time the creditor allows to pass without realizing the collection.” (*Translation*)

Gomez v. Ng Fat
75 Phil. 555

FACTS: A tenant was being ousted by his landlord on the ground of non-payment of rentals. The tenant’s defense was that the collector, who usually collected the rentals, did not appear and although he was willing to pay, still he was waiting for said collector. *Issue:* Was the tenant justified?

HELD: Yes, the tenant was justified. “It may also be remarked that the appellant’s (tenant’s) alleged default cannot give way to their ejectment, since it is attributable in part to plaintiff’s (owner’s) omission or neglect to collect.”

Eastboard Navigation, Ltd. v. Ysmael and Co.
L-9090, Sept. 10, 1957

If the court’s judgment confirming the award of a board of arbitrators does not specify the place where the obligation should be paid, the judgment debtor may pay it in his domicile (Manila). He cannot be required to pay his creditor in New York just because the latter happens to be there.

Gonzaga and Hernandez v.
Rehabilitation Finance Corp.
L-8947, Feb. 20, 1957

FACTS: A married couple obtained a loan from the Agricultural and Credit Bank of P37,000 with their land given by way of mortgage. The loan was contracted prior to the war. It was agreed that payment was to be made in *Manila*. During the war, the debtors paid *not* in *Manila* but in Iloilo, and the recipient of the money was not the Iloilo branch of the Agricultural and Credit Bank (for it was then closed) but the Iloilo branch of the *Philippine National Bank*, which was the depository in Iloilo of the funds belonging to the Agricultural and Credit Bank. After liberation, the married couple went to Manila, and asked for the cancellation of the mortgage on the ground that the indebtedness

of P37,000 had already been paid. The creditor refused. Instead of going to court, the married couple again borrowed from the creditor the “*additional* amount of P10,000” and as security, they offered a “*second mortgage*” on the same land that had been given as security before. Three years later, the married couple filed in court an action to cancel the mortgage on the P37,000 prewar loan on the ground of payment. *Issue*: Was the payment valid?

HELD: The payment was VOID because:

- 1) Payment was not made to the creditor or to his duly authorized agent. (If the Iloilo PNB branch acted as agent, it was an agent for the debtors, not for the creditor, for whom it was merely a depository of funds.)
- 2) Payment was made in Iloilo, not in Manila, which was the designated place.
- 3) The debtors are in estoppel (for instead of bringing a court action right away, after the creditor’s first refusal, they instead borrowed again “an additional sum of P10,000,” and executed a “second mortgage on the same land,” implying that they were willing to admit the *continued existence* of the first indebtedness of P37,000.

The payment being void, it follows that the mortgage remains valid and should not be cancelled.

Subsection 1

APPLICATION OF PAYMENTS

Art. 1252. He who has various debts of the same kind in favor of one and the same creditor, may declare at the time of making the payment, to which of them the same must be applied. Unless the parties so stipulate, or when the application of payment is made by the party for whose benefit the term has been constituted, application shall not be made as to debts which are not yet due.

If the debtor accepts from the creditor a receipt in which an application of the payment is made, the former cannot complain of the same, unless there is a cause for invalidating the contract.

COMMENT:**(1) Special Forms of Payment**

There are four special forms of payment:

- (a) application (or “imputation”) of payments (*Art. 1252, Civil Code*);
- (b) *dation* in payment (“*adjudicacion en pago*” or “*datio in solutum*”) (*Art. 1245, Civil Code*);
- (c) assignment in favor of creditors (“*cession*”) (*Art. 1255, Civil Code*);
- (d) tender of payment and consignment (*Arts. 1256-1261, Civil Code*).

(2) ‘Application of Payments’ Defined

“It is the designation of the debt to which should be applied a payment made by a debtor who owes several debts in favor of the same creditor.” (*Castan*). Stated differently, it is the phrase applied to show which debt, out of two or more debts owing the same creditor, is being paid.

(3) Importance

It is important to know rules on application of payments because otherwise, we may not know which one, of two or more debts, has been extinguished.

A owes *B* P1 million payable Apr. 1. *A* also owes *B* P1 million payable Apr. 5. On Apr. 10, *A* pays *B* P1 million. Here, we will not know which debt has been extinguished unless we know the rules on the application of payments.

(4) Requisites for Application of Payment to Be Made Use of

- (a) there must be two or more debts (severalty of debt);
- (b) the debts must be of the same kind;
- (c) the debts are owed by the *same debtor* in favor of the *same creditor* (thus, there must be only one debtor and only one creditor);

- (d) all the debts must be due (this includes a case when the benefit of the terms is given to the person making the application), unless of course the contrary has been stipulated);
- (e) the payment is not enough to extinguish all the debts.

(5) Rule When Debts Are Not Yet Due

Despite the fact that not all the debts are yet due, may there be application of payments under this Article?

ANS.: Yes, but only:

- (a) if the parties so stipulate, *or*
- (b) when the application of payment is made by the party for whose benefit the term has been constituted.

(6) Preferential Right of Debtor

It is the debtor who is given by the law the right to select which of his debts he is paying. This right is not *absolute*, however. For example:

- (a) If there was a valid prior but contrary agreement, the debtor cannot choose;
- (b) The debtor cannot choose to pay part of the principal ahead of the interest (*Art. 1253, Civil Code and Sunico v. Ramirez, 14 Phil. 500*), unless the creditor consents.

If the debtor makes a *proper* application and the creditor *refuses*, the creditor will be in *mora accipiendi*.

(7) How Application of Payment Is Made

- (a) The debtor makes the designation. (*Art. 1252, par. 1, Civil Code*);
- (b) If not, the creditor makes it, by so stating in the *receipt* that he issues, “unless there is cause for *invalidating the contract*.” (*Art. 1251, par. 2, Civil Code*);

[NOTE: Thus, if the obligation itself is void, the *application and the payment* are also void. (*Sanchez Roman*).

If the debtor's consent in accepting the receipt was *vitiated* — as by fraud, error, or violence — the application is *not valid, i.e.,* it is voidable.]

- (c) If *neither* the debtor nor the creditor has made the application, or if the application is *not* valid, then application is made by operation of law. (*Arts. 1253 and 1254, Civil Code*).

(8) Application Made by Creditor

If the creditor makes the application without the knowledge and consent of the debtor, the application is not valid. (*Bank of the Phil. Islands v. Espinosa, [CA] 40 O.G. Sup. 4, p. 68, Aug. 23, 1941*).

Bank of the Phil. Islands v. Espinosa (C.A.) 40 O.G. Sup. 4, p. 68, Aug. 23, 1941

FACTS: A and B borrowed P5,000 from a bank. The liability of A and B in this contract was solidary. A gave B a check worth P2,000; B presented the check to the bank and B got the money. Later C, a debtor of A, paid the account of P5,000 to the bank. The bank said that its total credit was P7,000 (P5,000 from A and B, P2,000 from A), and that since only P5,000 has been paid, A and B still owe P2,000 solidarily. B pleaded as his defense, payment of the original P5,000 and that therefore he should be released from all liability. Decide the case.

HELD: B's obligation has already been extinguished. The bank had no right to include the P2,000 to the solidary debt of P5,000. Such application was not made with the knowledge and consent of the debtor B. Only A is liable therefor.

(9) Revocation of the Application

Once an *application of payments* is made, may it be *revoked*?

ANS.: No (*Bachrach Garage & Taxicab Co. v. Golingco, 39 Phil. 912*), unless both parties agree. Even if both parties agree, however, still the *revocation* or *change* in the application (by crediting the payment to another debt) will *not* be allowed if third persons would be prejudiced.

(10) When Application Must Be Made

Application must be made at the time when payment by the debtor is made, not afterwards. (*Powell v. Nat. Bank*, 54 Phil. 54).

(11) Examples of How a Creditor Makes the Application

- (a) When the debtor *without* protest accepts the *receipt* in which the creditor specified expressly and unmistakably the obligation to which such payment was to be applied, said debtor renounced the right of choice. (*Kandar v. Dannug*, [CA] 43 O.G. 3176; see *Liggett & Myers Tobacco Corp. v. Assn. Insurance, et al.*, L-15643, Oct. 31, 1960).
- (b) When monthly statements were made by the bank specifying the application and the debtor signed said statements approving the status of her account as thus sent to her monthly by the bank. (*Garcia v. Enriquez*, 54 Phil. 423).

Powell v. Nat. Bank
54 Phil. 54

FACTS: A owed B debts already due. A paid for one debt, without specifying which. After said payment had been credited, A complained, stating that he had the right to choose which debt to pay under the application of payments. *Issue:* Is A justified in his complaint?

HELD: No, A is not justified in his complaint. It is true that originally, he had the right to specify the debt to which he wanted the payment applied, but since he did not do so at the time of payment, it is as if he has given up his right. Hence, the legal rules stated in the Civil Code must be the ones applied, not his application. "Suffice it to say that such application should have been made at the time of payment, and not afterwards, when his account with the bank had already been credited."

(12) When Application of Payments Cannot Be Availed of

- (a) In the case of a partner-creditor under *Art. 1792* of the Civil Code which reads:

“If a partner authorized to manage collects a demandable sum which was *owed to him* in his own name, from a person who *owed the partnership another sum also demandable*, the sum thus collected shall be applied to the two credits in proportion to their amounts, *even though* he may have given a receipt for his own credit only; but should he have given it for the account of the partnership credit, the amount shall be fully applied to the latter. The provisions of this Article are understood to be *without prejudice* to the right granted to the *debtor* by Art. 1252, *but only* if the personal credit of the partner should be more onerous to him.”

- (b) The right cannot be invoked *by a surety or a solidary guarantor*. (*Socony-Vacuum Corp. v. Miraflores*, 67 Phil. 304). (*The petition for certiorari here was dismissed by the Supreme Court in Socony-Vacuum Corp. v. Miraflores*, 67 Phil. 304). The reason is that he has only one debt, and even that is contingent (dependent) on the principal debtor’s failure to pay.

**Reparations Commission v.
Universal Deep-Sea Fishing Corp.
L-21901, L-21996, Jun. 27, 1978**

A surety who guarantees a debtor’s debt of P536,428.44 for the amount of P53,643.00 is still liable for P10,000. It is wrong to apply the P10,000 to the secured portion of the debt — as in the case of application of payments. Said rule on application of payments is to be used only in case a debtor owes debts in favor of several creditors.

Art. 1253. If the debt produces interest, payment of the principal shall not be deemed to have been made until the interests have been covered.

COMMENT:

(1) Interest Must Be Paid First

The Article is *obligatory*, that is, the debtor cannot insist that his payment be credited to the principal instead of the inter-

est. However, if the creditor agrees, this is all right. (*8 Manresa 317*).

**Rosete, et al. v. Perober Dev. Corp.
CA-GR 61032-R, Jul. 31, 1981**

Under the law, payment that is made to a creditor must be credited to interest (that is already due) ahead of the principal. The interest can refer not only to interest on amounts already due but also to interest on future installments, if said installments are eventually not paid on time.

(2) Effect if Payment Is Credited to the Principal

Reduction of the principal would, of course, result in the decrease of the total interest collectible.

(3) What Interest Is Supposed to Be Paid

- (a) interest by way of compensation; and
- (b) interest by way of damages due to default.

Reason: The law makes no distinction.

Art. 1254. When payment cannot be applied in accordance with the preceding rules, or if application cannot be inferred from other circumstances, the debt which is most onerous to the debtor, among those due, shall be deemed to have been satisfied.

If the debts due are of the same nature and burden, the payment shall be applied to all of them proportionately.

COMMENT:

(1) Rules in Case No Application of Payment Has Been Voluntarily Made

- (a) Apply it to the *most onerous* (in case the due and demandable debts are of *different* natures).
- (b) If the debts are of the same nature and burden, application shall be made to all *proportionately*.

[NOTE: If one debt is for P1 million, and another is for P2 million and only P1 million is paid, how will the payment be applied?]

ANS.:

- 1) If the debtor makes the application, the payment should be credited to the *first debt*. The debtor cannot insist that the creditor accept it for the second debt for insofar as the second debt is concerned, it is only a partial payment. And under the law, a creditor cannot generally be compelled to receive partial payment. (*Art. 1248, Civil Code*).
- 2) If no application has been made, the law steps in, and application will be made, *not* equally but proportionately. (*Art. 1248, Civil Code*).

(2) Samples of More Burdensome (More Onerous) Debts

- (a) Older ones in case of running accounts. (*Nat. Bank v. Veraguth, 50 Phil. 253*).
- (b) Interest-bearing debts even if the non-interest bearing debt is older. (*Menzi & Co. v. Quing Chuan, 69 Phil. 46*).
- (c) Of two interest-bearing debts, that which charges the higher interest is more burdensome. (This follows from the very nature of things.)
- (d) Debts secured by mortgage or by pledge. (*Mission de San Vicente v. Reyes, 19 Phil. 525 and Sanz v. Lavin Bros., 6 Phil. 299*).
- (e) Debts with a penalty clause.
- (f) Advances for subsistence are more onerous than cash advances. (*Montinola v. Gatila, 97 Phil. 999*).
- (g) A debt where the debtor is in *mora* is more onerous than one where he is not.
- (h) An *exclusive* debt (not solidary) is more onerous than a solidary debt. (*Commonwealth v. Far Eastern Surety, 83 Phil. 305*).

[*NOTE*: If a principal debtor is guaranteed by a surety but the guaranty is for a *smaller* amount, any *partial* payment made by the debtor shall be applied to the *portion* which is NOT secured, since this exclusive debt is considered more onerous to him. (*Hongkong & Shanghai Bank v. Aldanese*, 48 Phil. 990).]

Hongkong & Shanghai Bank v. Aldanese
48 Phil. 990

FACTS: A set up a bond in the sum of P10,000, secured by a surety who agreed to be responsible solidarily with A but only up to P8,000. A pays P1,500 to the creditor, without specifying the application of the payment. *Issue*: Should this be applied to the P8,000 for which the surety is also responsible or for the P2,000 which was not guaranteed?

HELD: The P1,500 should be applied to the P2,000 which was not guaranteed. This is so because as regards the principal debtor A, said P2,000 is more onerous than the P8,000 he solidarily owed together with the surety. This is so because the surety fixed his liability at an amount lower than that due from the principal debtor.

[*NOTE*: The “more burdensome” rule does *not* apply when the debtor has made application of payment.

Example:

A owes B two debts, both of which are already due. The *first* debt is secured by a mortgage, the *second* is not. A tells B that the payment he is now making should be applied to the *second* debt, instead of the *first*. B refuses to accept such application on the ground that the first debt is more burdensome to the debtor, and that, therefore, payment must be applied to it first. Is B correct?

ANS.: No, B is not correct because although it is true that the mortgage debt is more onerous, still the preference of the debtor himself must be followed. This is so because Art. 1254 cannot be applied in case application of payments has been made by the debtor in accordance with Art. 1252. Besides, it is not the creditor’s business to go against the

wishes of the debtor who prefers to leave unpaid the more burdensome obligation here, for the person who might be prejudiced anyway, if at all, will be the debtor, not the creditor. (As implied from the case of *Garcia v. Enriquez*, 40 O.G. {13 S} No. 21, p. 219, 71 Phil. 423, which held that the more burdensome rule is not applicable when there has been application of payment).]

(3) Determination of Which Obligation Is Most Onerous

Sometimes it is easy, and sometimes it is hard to determine which obligation is the most onerous. The reason is that the burden may be relative. It follows, therefore, that no hard and fast rules can be put up, because what may be true in one case may not be true in another case. (8 *Manresa* 319). This becomes more evident when not one circumstance alone is considered but a combination of different circumstances as when:

Obligation A — is secured by a mortgage, non-interest bearing, and recent.

Obligation B — is unsecured, but maximum interest bearing, and old.

In such cases, the particular circumstances which have significant bearing on the case at hand should be observed and the balancing must be done. However, as a last resort, when it cannot definitely be determined whether one debt is more burdensome than the other, the author believes that both will be considered equally burdensome, and hence payment must be applied to both *pro rata*.

(4) Problem

If one debt is P1.2 million and the other is P600,000, and the debtor without making any application of payment gives P300,000, how should said payment be applied, presuming that both are of the same nature and burden?

ANS.: The payment will be applied proportionately. Hence, P200,000 will be deducted from the first, and P100,000 will be deducted from the second. The first debt will now be P1 million and the second will be P500,000. The ratio here of the first debt to the second debt is thus preserved, namely, 2 is to 1.

Subsection 2

PAYMENT BY CESSION

Art. 1255. The debtor may cede or assign his property to his creditors in payment of his debts. This cession, unless there is stipulation to the contrary, shall only release the debtor from responsibility for the net proceeds of the thing assigned. The agreements which, on the effect of the cession, are made between the debtor and his creditors shall be governed by special laws.

COMMENT:

(1) Cession or Assignment in Favor of Creditors Defined

It is the process by which a debtor transfers all the properties not subject to execution in favor of his creditors so that the latter may sell them, and thus apply the proceeds to their credits. (*See 8 Manresa 323; Castan; and Art. 1255*).

(2) Kinds or Classes of Assignment

- (a) *Legal* (This is governed by the Insolvency Law; [Sec. 8, Act 1956]). (The *majority* of creditors must agree.)
- (b) *Voluntary* (This is what is referred to in Art. 1255.) (*All* the creditors must agree.)

(3) Requisites for Voluntary Assignment

- (a) more than one debt;
- (b) more than one creditor;
- (c) complete or partial insolvency of debtor;
- (d) abandonment of all debtor's property not exempt from execution (unless exemption is *validly* waived by debtor) in favor of creditors;
- (e) acceptance or consent on the part of the creditors (for it cannot be imposed on an unwilling creditor). (*Gov't. v. Lukban, [CA] 37 O.G. 1444*).

(4) Effect of Voluntary Assignment

- (a) The creditors do not become the owners; they are merely assignees with authority to sell. (If ownership is transferred, this becomes a *dation in solutum*.)
- (b) The debtor is released up to the amount of the net proceeds of the sale, unless there is a stipulation to the contrary. (*Art. 1255, 2nd sentence*). The balance remains collectible.
- (c) Creditors will collect credits in the order of preference agreed upon, or in default of agreement, in the order ordinarily established by law.

[NOTE: Some properties should not be assigned, such as:

- 1) the family home, whether judicially or extrajudicially created, save in certain exceptions (*See Arts. 223, 226, Civil Code*);
- 2) the amount needed by the debtor to support himself and those he is required by law to support. (*See Art. 750, Civil Code*). (If such amount is not reserved, the *cession* is not void but *merely reducible* to the extent that the support is impaired. The party prejudiced can ask the court for the reduction.) (*See by implication Agapito v. De Joya, {C.A.} 40 O.G. No. 3526*).]

(5) CESSION Distinguished from DACION EN PAGO

<i>DACION EN PAGO</i>	<i>CESSION</i>
a) does not affect ALL the properties	a) in general, affects ALL the properties of the debtor
b) does not require plurality of creditors	b) requires <i>more than one creditor</i> (<i>See Art. 1255 and 8 Manresa 324</i>)
c) only the specific or concerned creditor's consent is required	c) requires the consent of <i>all</i> the creditors

d) may take place during the solvency of the debtor	d) requires full or partial insolvency
e) transfers ownership upon delivery	e) does <i>not</i> transfer ownership
f) this is really an act of novation	f) not an act of novation

(See 8 Manresa 323).

[NOTE: In one case, the Supreme Court *mistakenly* referred to a “renouncing” of one’s acquired inheritance in favor of a creditor of a *single debt*, as a *cession* instead of a *dation*. (See *Ignacio v. Martinez*, 33 Phil. 576).]

Subsection 3

TENDER OF PAYMENT AND CONSIGNATION

INTRODUCTORY COMMENT:

(1) ‘Tender of Payment’ Defined

The act of offering the creditor what is due him together with a demand that the creditor accept the same.

Soco v. Judge Militante
GR 58961, Jun. 28, 1983

The objective of notice *prior* to consignation is to give the creditor a chance to reconsider his refusal to accept payment. In this way, consignation and litigation may be avoided. On the other hand, the purpose of notice *after* consignation is to enable the creditor to withdraw the money or goods deposited with the judicial authorities.

(2) ‘Consignation’ Defined

The act of depositing the thing due with the court or judicial authorities whenever the creditor cannot accept or refuses to accept payment. It *generally* requires a prior tender of payment. (*Limkako v. Teodoro*, 74 Phil. 31).

**De Vera, et al. v. Republic, et al.
L-32998, Jul. 12, 1973**

If the lessor refuses to accept the payment of rentals, what the lessee should do is to resort to judicial deposits of the corresponding amounts.

(3) ‘Tender of Payment’ Distinguished from ‘Consignation’

“The clear meaning of these words show their difference. TENDER is the antecedent of CONSIGNATION, *i.e.*, an act preparatory to the consignation, which is the principal, and from which are derived the immediate consequences which the debtor desires or seeks to obtain. TENDER of payment may be extrajudicial, while CONSIGNATION is necessarily judicial, and the priority of the first is the attempt to make a private settlement before proceeding to the solemnities of consignation.” (8 *Manresa* 325).

(4) Rules on Payment Must Be Complied With

Tender of payment and consignation, to extinguish the debtor’s obligation must comply with the requisites provided in Arts. 1256-1258 of the Civil Code. Thus, if the debtor made a tender of payment by telegraphic transfer sent to the clerk of court, and the same was not received by the creditor, but instead returned to the debtor, it cannot be given effect. (*Alemars v. Cagayan Valley College, Inc.*, L-11270, Apr. 8, 1958).

Art. 1256. If the creditor to whom tender of payment has been made refuses without just cause to accept it, the debtor shall be released from responsibility by the consignation of the thing or sum due.

Consignation alone shall produce the same effect in the following cases:

- (1) When the creditor is absent or unknown, or does not appear at the place of payment;**
- (2) When he is incapacitated to receive the payment at the time it is due;**

- (3) **When, without just cause, he refuses to give a receipt;**
- (4) **When two or more persons claim the same right to collect;**
- (5) **When the title of the obligation has been lost.**

COMMENT:

(1) Effect of Tender Without Consignation

Tender of payment *without* consignation does not extinguish the debt; consignation must follow. (*Capalungan v. Medrano, L-13783, May 18, 1960*).

Examples:

- (a) A owes B a sum of money. A gives B the money but B refuses without just reason to accept it. What should A now do?

ANS.: A must deposit the money in court, since his tender of payment was refused without just reason. His deposit in court is called consignation.

- (b) When a debtor owes money lent him with interest, is it sufficient to just tender the principal without the interest?

ANS.: No. The tender of the principal must be accompanied with the tender of the interest which has accrued. (*Fiege & Brown v. Smith, Bell & Co., and Cowper, 43 Phil. 113*). Otherwise, said tender will not be valid.

Velez v. Avelino
L-48448, Jan. 20, 1984

If a lessee tenders his rent but the lessor refuses to accept the same, the former must consign the rent in court (by first filing an action for consignation) or else deposit the rent in a bank, under the lessee's name (with the lessee being notified of the deposit). If this is not done, ejectment may prosper under Batas Pambansa Bilang 25.

(2) When Consignation Is Not Required

In some cases, however, consignation is *not* required, mere tender being needed. This is so where there really exists no debt, no obligation, and where therefore payment is *purely voluntary*, that is, the person offering, at his option, could have refused to offer. This may happen in the case of *OPTIONS* (*Asurias Sugar Central v. Pure Cane Molasses Co.*, 60 Phil. 255), or in the case of a *PACTO DE RETRO* (*Villegas v. Capistrano*, 9 Phil. 416 and *Rosales v. Reyes*, 25 Phil. 495), or in the case of *LEGAL REDEMPTION* (*De Jesus & Tablan v. Garcia*, [C.A.] 47 O.G. 2406), where only a *right*, not a duty, exists. Thus, if one is granted an option to buy he may or he may not buy, at his choice; if one is granted the right to redeem, he may or he may not redeem also at his own choice.

**Villegas v. Capistrano
9 Phil. 416**

FACTS: A sold B a piece of land with the right of repurchase. Within the time given for redemption, A tendered the amount to B to effect the resale. But B refused. A, however, did not consign the money in court. A brought an action in court to compel B to accept the repurchase price. B claims that A should have deposited the money in court, but since A did not do so, and since the period of redemption has already lapsed, A cannot now redeem the property. *Issue:* Was consignation needed here?

HELD: No. Consignation is not needed. The deposit of the purchase price is indeed not necessary to compel the purchaser to make the resale, if he (B, the original purchaser) refuses to accept the money.

Reason: The acticles on consignation refer only to debts. A here was not a debtor of B, inasmuch as A was free either to repurchase the property or not.

[*NOTE:* In the above-mentioned case it should be noted that consignation is not required to *preserve the right of redemption*. However, there is really *no redemption* yet unless payment was actually made or the price consigned. Stated differently, it is true that consignation of the redemption price is *not necessary*

in order that the vendor may compel the vendee to allow the repurchase (*Rosales v. Reyes & Ordaneza*, 25 Phil. 495), mere tender of payment being enough, if made *on time* as a basis for action against the vendee to compel him to resell. But that tender *does not in itself* relieve the vendor from his obligation to pay the price when redemption is allowed by the court. Hence, mere tender is sufficient to *compel redemption* but is not in itself payment. (*Paez v. Magno*, 83 Phil. 405).]

Co v. PNB
L-61787, Jun. 29, 1982

If the tender of *redemption* money is refused, there is no need to consign it in court.

(3) When Creditor Is Justified in Refusing Tender of Payment

The creditor is justified in refusing to accept the tender of payment if the tender of payment is *not valid*. To be valid, the tender of payment must have the following requisites:

- (a) It must be made in *legal tender* (lawful currency). Thus, tendering by way of a check, even a manager's check is made, the defect in tender may be considered cured. (*Mialhe Desbarats v. Varela*, L-4915, May 25, 1956).

Far East Bank and Trust Co. v. Diaz Realty
GR 138588, Aug. 23, 2001

For a valid tender of payment, it is necessary that there be a fusion of intent, ability, and capability to make good each offer, which must be absolute and cover the amount due.

Though a check is not legal tender, and a creditor may validly refuse to accept it if tendered as payment, one who, in fact, accepted a fully-funded check after the debtor's manifestation that it had been given to settle an obligation is estopped from later on denouncing the efficiency of such tender of payment.

(NOTE: In *Lapuz Sy v. Eufemio*, L-10572, Sept. 30, 1958, the Supreme Court held that a check intended to pay a debt, if *refused* by the obligee or creditor is *not* a valid tender of payment. The fact that in previous years, payment in check by the debtor was accepted by the creditor does *not* place the latter in estoppel to prevent him from requiring the former to pay his obligation in cash.)

- (b) It must include whatever interest is due. (*Fiege & Brown v. Smith, Bell & Co.*, 43 Phil. 113).
- (c) Generally, it must be unconditional. (*Phil. Nat. Bank v. Relativo, et al.*, 92 Phil. 203). But if made with conditions, and accepted by the creditor *without* protest, the creditor cannot later on prescribe the terms for the validity of the acceptance which he had already made. (*Vidal, Araneta & Co. v. Uy Teck*, [CA] 40 O.G. [Supp. 12], p. 28).
- (d) The obligation must already be due. (*Salvante v. Ubi Cruz*, 88 Phil. 236).

(4) Running of Interest

- (a) If after tender, consignation is made *very much later* (one year, for example), *interest should run* until the principal is paid. (*Llamas v. Abaya*, 60 Phil. 502).
- (b) Although a certified check is not legal tender, still if it is tendered, but refused on ground *other than the fact that it is not legal tender*, and the refusal is immediately followed by consignation —

- 1) Is the debt extinguished?

ANS.: No, because among other things, the check is not legal tender, and therefore the consignation was not valid.

- 2) Did interest run from the date of tender?

ANS.: No, because the tender was made in good faith; the check could readily be converted to cash in view of the certification that the debtor really had sufficient funds in the banks; and finally because after all, the cause for refusal to accept was a ground *other*

than that it was not legal tender. (Gregorio Araneta, Inc. v. Tuason de Paterno & Vidal, 91 Phil. 686).

(NOTE: In this case, the creditor had refused the tender because according to him the debt was not yet due, and he did not want to accept the check because the tender took place during the Japanese occupation, and he did not want Japanese money. The Court held however that the debt was already due, and, therefore, payable.)

(5) When Consignation Is Sufficient Even Without a Prior Tender

Consignation alone (without tender) is allowed in the following cases:

- (a) When the creditor is ABSENT or UNKNOWN or DOES NOT APPEAR at the place of payment. (The creditor need *not* be judicially declared absent.)
- (b) When the creditor is INCAPACITATED to receive payment at the time it is due. (The rule does *not* apply if the creditor has a legal representative and this fact is known to the debtor.)
- (c) When, *without just cause*, the creditor REFUSES to give a receipt. (Query: Does this not presuppose a *prior tender*, for otherwise, how can there be a refusal?)
- (d) When *two or more* persons claim the *same right* to collect. (An action in INTERPLEADER would be proper here.)
- (e) When the *title (written document)* of the obligation has been LOST.
- (f) When the debtor had previously been notified by the creditor that the latter would *not* accept any payment. (*Banahaw, Inc. v. Dejarme, 55 Phil. 338*).

Rural Bank v. Court of Appeals L-32116, Apr. 21, 1981

While tender generally precedes consignation, consignation may be allowed without prior tender

in certain cases (*e.g.*, if there are considerations of equity as when a prior tender or offer appears to be useless).

Art. 1257. In order that the consignation of the thing due may release the obligor, it must first be announced to the persons interested in the fulfillment of the obligation.

The consignation shall be ineffectual if it is not made strictly in consonance with the provisions which regulate payment.

COMMENT:

(1) Essential Requisites for Consignation

- (a) existence of a valid debt
- (b) valid prior tender, unless tender is excused
- (c) *prior* notice of consignation (*before* deposit)
- (d) actual consignation (deposit)
- (e) subsequent notice of consignation

(2) First Requisite — Existence of a Valid Debt

- (a) In the case of an *option*, there is a privilege, not an obligation or a debt.

Example: A was given an option to cancel a contract provided he paid P600,000. Mere tender is sufficient to *preserve the right* to cancel. (*See Asturias Sugar Central v. Pure Cane Molasses*, 60 Phil. 255). The same is true in the case of an option to buy given to a lessee. (*See Vda. de Quirino v. Palarca*, L-28269, Aug. 15, 1969).

- (b) In the case of *legal* redemption, there is as yet no debt (for this again is a right, not a debt or duty). (*De Jesus v. Garcia*, [C.A.] 47 O.G. 2406).
- (c) So also, in the case of *conventional redemption* (this again is a right, not an obligation). (*Rosales v. Reyes*, 25 Phil. 495).

- (d) So also, if the alleged debt has prescribed (for here, there is no more debt).
- (e) So also, if the debt is founded on an illegal cause or consideration, or if for any other reason, *null* and *void*.
- (f) So also, if the obligation of the debtor is conditional, and the condition has *not* been fulfilled. (*See Sotto v. Mijares, L-23563*).
- (g) But a mortgage debt is a true and valid debt, and payment here is a DUTY. (*Capalungan v. Medrano, L-13783, May 18, 1960*).

(3) Second Requisite — Valid Prior Tender Unless Tender Is Excused

- (a) If tender is required, it must be a valid one. (Therefore, it must be the very object agreed upon or if a monetary debt, must be *legal tender*; unless the cause for refusal is some other ground, it must be unconditional; also it must include whatever interest is due (*Phil. Nat. Bank v. Relativo, 92 Phil. 208; Araneta, Inc. v. Tuason de Paterno Vidal, 91 Phil. 686 and Fiege and Brown v. Smith, Bell & Co., 43 Phil. 113*), or any tax and assessments that may have been paid properly by the creditor. (*Miranda v. Reyes, L-24791, Aug. 29, 1969*). The tender must also be in full satisfaction of the claim, not merely a partial payment thereof. (*Joe's Radio and Electrical Supply v. Alto Electronics and Alto Surety, L-12376, Aug. 22, 1958*).
- (b) For the instances when tender is excused. (*See par. 2, Art. 1256, Civil Code and comment No. 5 under said Article*).

**Ludwig Hahn v. Lazatin, et al.
L-11346 and L-11549, Jun. 30, 1959**

A consignment to be valid must be preceded by a refusal without reason to accept the debtor's tender of payment. In the case at bar, plaintiff's refusal to accept the tender of payment on Aug. 4, 1944 was justified *because* under the provisions of the contract, the date of maturity was Jan. 1945. Thus, the consignment made was NULL and VOID.

(4) Third Requisite — Prior Notice to Persons Interested

- (a) The law says the consignation “must *first* be announced to the persons interested in the fulfillment of the obligation.” (*Art. 1257, par. 1, Civil Code*).
- (b) Without such notice, the consignation as a payment is VOID. (*Limkako v. Teodoro, 74 Phil. 313 and Lagonera v. Macabalag, [CA] 49 O.G. p. 569*). The reason is because, had notice been made, the creditor would have had opportunity to withdraw the money consigned and thus make use of it. (*Lagonera v. Macabalag, [CA] 49 O.G. p. 569*) ONE EXCEPTION to the rule is when any attempt to give such notice would be *useless*, as when the creditor was traveling from place to place and could not be located. (*Pacis v. Castro, [CA] 43 O.G. 5119*).
- (c) *Purpose of the notice:* To enable the creditor and other parties interested (such as the mortgagees, pledgees, guarantors, solidary co-creditors, and solidary co-debtors) to reconsider the previous refusal, and thus, avoid litigation by the simple expedient of accepting payment. (*Cabanos, et al. v. Calo, et al., L-10927, Oct. 3, 1958*).

**Soco v. Judge Militante
GR 58961, Jun. 28, 1983**

Tender of payment ought to be made in lawful currency or legal tender. The tender of a check to pay a monetary obligation is *not* a valid tender of payment. Even if in previous years, the creditor had accepted check payments, this will not put him in estoppel. Thus, he can still require the debtor to pay in cash.

- (d) Needless to say, the notice of consignation may be made by merely giving notice of the debtor’s *intention to take the case to court, in the event that tender is rejected*. (*Valenzuela v. Bakani, L-4689, Aug. 31, 1953*). This is to say that the first notice of consignation may be accomplished *simultaneously* with the tender of payment. In the *Valenzuela* case, two letters were sent to the creditor, which aside from offering the price, expressly advised that, if no answer thereto was received, the proper judicial action would be instituted.

However, it would be better to state in such first notice the following:

- 1) that tender had been made (unless excused) on a specified date;
 - 2) that tender has been unjustifiably rejected;
 - 3) that deposit in court is being contemplated at a certain specified date and at a certain specified court. (*Ochoa v. Lopez*, [CA] GR 7050-R, Jun. 18, 1954).
- (e) The notice, however, is NOT essential if the sum to be deposited is the sum due under a final judgment. (*Arzaga v. Rumbaoa*, 91 Phil. 499).
- (f) Consignation presupposes the existence of a *suit* to compel the creditor to accept. Without a suit, there can be *no* consignation, and therefore no discharge. (*El Hogar Filipino v. Angeles*, L-11613, Sept. 30, 1958).

**Hulganza, et al. v. C.A.
GR 56156, Jan. 7, 1987**

FACTS: A is the registered owner of a parcel of land covered by an original certificate of title issued pursuant to a free patent. He sold said parcel to B and by virtue of the sale, the original title was cancelled and a new one issued in favor of B. A year later, A sued B in the Court of First Instance (now Regional Trial Court) to compel B to allow A to redeem said lot under Sec. 119 of Com. Act 141 (Public Land Act). The trial court declared that A has the legal right to exercise said right at the original purchase price with interests. The Court of Appeals reversed the trial court's decision on the ground that A failed to consign the amount due at the time they filed the complaint, saying that the act of merely filing the complaint on the part of A without consignation of the proper amount within the period prescribed was an ineffective and incomplete redemption.

HELD: The *bona fide* tender of the redemption price or its equivalent — consignation of said price in court — is not essential or necessary since the filing of the action itself is equivalent to a formal offer to redeem.

(5) Fourth Requisite — Actual Deposit with the Proper Judicial Authorities

- (a) It is understood that before a deposit is made, a complaint against the creditor to compel him to accept has to be first filed in court.
- (b) The consignment must be made —
 - 1) by depositing the very object that is due (and not another) (*Cabrera v. Lopez*, 84 Phil. 834);
 - 2) with the *proper judicial authority* which, in certain case, may include the sheriff (*Fabros v. Villa Agustin*, 18 Phil. 336);
 - 3) accompanied by proof that tender had been duly made, unless tender is excused (*Art. 1258, par. 1*); and that first notice of the consignment had already been sent (*Art. 1258, par. 1, Civil Code*).

[NOTE: The judicial deposit of the money due under a *final judgment* does not require notices to the proper interested parties. (*Arzaga v. Rumbaoa*, 91 Phil. 499 and *Salvante v. Ubi Cruz*, 88 Phil. 236).]

- (c) *Effects of the deposit*
 - 1) The property is “*in custodia legis*.” (*Manejero v. Buyson Lampa*, 61 Phil. 66);
 - 2) And will, therefore, be *exempted* from attachment and execution (*Springer v. Odlin*, 3 Phil. 344 and 23 C.J., p. 357, Sec. 107);
 - 3) But if the property is *perishable* by nature, the court may order the sale of the property (*Matute v. Cheong Boo*, 37 Phil. 372);
 - 4) In the meantime, the debtor, by consigning the thing, practically makes himself the agent or receiver of the court, particularly if for some reason, the property cannot actually be placed in the hands of the court. (*Matute v. Cheong Boo*, 37 Phil. 372). This is particularly true when the object involved is REAL PROPERTY. The proper thing to do, however, in such a case is to ask the court for a RECEIVERSHIP (*Reyes*

and *Puno*, *Outline of Philippine Civil Law*, Vol. 4, pp. 130-131), because ordinarily, unless such deposit is made, payment *cannot* be made and consequently, the obligation would remain in force. (*Magsaysay v. Blanco*, 50 O.G. 1152). Indeed, the payment would be void. (*Halili v. Lloret*, 95 Phil. 78).

St. Dominic Corp. v. IAC
GR 67207, Aug. 26, 1985

Where the court's decision states that the balance of the purchase price must be made within 60 days from receipt hereof, the judgment debtor must pay the amount within a reasonable time thereafter and not from the time the judgment becomes final.

If the judgment creditor refuses to receive the payment, the proper procedure is for the judgment debtor to consign the same with the court also within the 60-day period or within a reasonable time thereafter. The fact that the judgment debtor tried to reach an agreement with the judgment creditor after the promulgation of the decision does not affect the finality of the judgment.

(6) Fifth Requisite — Subsequent or Second Notice (Made After the Deposit)

- (a) This is required by the law which says: "The consignation having been made, the interested parties shall be notified thereof." (*Art. 1258, par. 2, Civil Code*).
- (b) This is mandatory and, therefore, without such subsequent notice, the consignation is VOID (*Tiaoqui v. China Insurance & Surety Co., Inc.*, [CA] 45 O.G. 2558) unless the amount due is as a consequence of a FINAL JUDGMENT, inasmuch as the law refers only to a contractual debt, not to one decreed by the court. (*Salvante v. Ubi Cruz*, 88 Phil. 236 and *Arzaga v. Rumbaoa*, 91 Phil. 499).
- (c) *FORM*: It would be advisable to issue a formal notice; however, it has been held that the mere filing of the complaint and the *service of summons* on the defendant-creditor, *ac-*

accompanied by a copy of the complaint, can take the place of said second notice. (Andres v. Court of Appeals, 47 O.G. 2876; Limkako v. Teodoro, 74 Phil. 313 and Dungao v. Roque, L-4140-4141, Dec. 29, 1951).

Art. 1258. Consignation shall be made by depositing the things due at the disposal of judicial authority, before whom the tender of payment shall be proved, in a proper case, and the announcement of the consignation in other cases.

The consignation having been made, the interested parties shall also be notified thereof.

COMMENT:

How Consignation Is Actually Made

- (a) The things due must be deposited with the proper judicial authorities (while ordinarily the cashier or the cash officer should be the person to issue the receipt for the money consigned, a temporary receipt issued by the clerk of court for said deposit would suffice). (*See Yap v. Tingin, L-18943, May 31, 1963*).
- (b) There must be PROOF that:
 - 1) tender had previously been made (general rule);
 - 2) or that the creditor had previously notified the debtor that consignation will be made (in case tender is *not* required).

Art. 1259. The expenses of consignation, when properly made, shall be charged against the creditor.

COMMENT:

(1) Creditor Generally to Bear Expenses of Consignation

Reason why the creditor pays the expenses of the consignation if *properly* made: Clearly, this consignation is due to the *creditor's fault*, for had he accepted, there would not have been any need for the consignation. If not properly made, the consignation expenses are, of course, chargeable to the debtor.

(2) The Expenses

The expenses include those for the preservation or warehousing of the goods pending litigation. (*Matute v. Cheong Boo*, 37 Phil. 372).

Art. 1260. Once the consignation has been duly made, the debtor may ask the judge to order the cancellation of the obligation.

Before the creditor has accepted the consignation, or before a judicial declaration that the consignation has been properly made, the debtor may withdraw the thing or the sum deposited, allowing the obligation to remain in force.

COMMENT:**(1) Effects if Consignation Has Been Duly Made**

If the consignation is DULY (properly) made:

- (a) The debtor may ask the judge to order the *cancellation* of the obligation.
- (b) The running of interest is suspended.
- (c) However, it should be observed that before the creditor ACCEPTS, or before the judge declares that consignation has been PROPERLY MADE, the obligation REMAINS. (*Padua v. Rizal Surety*, 47 O.G. Supp. No 12, p. 308).

[NOTE: No judicial approval is needed if ALL the essential requisites for a valid consignation are present. This is particularly true when the deposit and the records of the case are accidentally destroyed, but there is NO reason shown why the consignation should be considered improper. (*Sia v. Court of Appeals*, 92 Phil. 335).]

(2) Risk of Loss

If the consignation is judicially approved OR if all the essential requisites are present OR if the creditor has signified his acceptance, the creditor bears the loss; otherwise, it is the debtor who bears the burden. (*See Sia v. Court of Appeals*, 92

Phil. 335; see also Chua Kay v. Lim Chang, L-5995, May 18, 1956).

(3) Effects of Improper Consignation

- (a) If the consignation was *improperly* made, the obligation remains, because the consignation is NOT EFFECTIVE as a payment. (*Bravo v. Barreras, 92 Phil. 679*).
- (b) If at the time of consignation the debt was already due, and the requisites for consignation are absent, the debtor is in DEFAULT.

(4) Effect of Dismissal of the Case

If the case in which consignation was made is dismissed by the court, the consignation naturally would produce NO effect. (*Bravo v. Barreras, 92 Phil. 679*).

[NOTE: The same thing results if there is failure to reconstitute the case, for here there would be WAIVER. (*Valenzuela v. De Aquino, L-2262, Aug. 31, 1949 and Chua Kay v. Lim Chang, L-5995, May 18, 1956*).]

(5) Query

Suppose one of the essential requisites for consignation is not present, may the debtor ask for the cancellation of the obligation?

ANS.: Yes, provided the creditor does not object. This would have the effect of a waiver. (*See Limkako v. Teodoro, 74 Phil. 313*).

(6) When Debtor May Withdraw the Thing or Sum Consigned

- (a) As a matter of *right*:
 - 1) *before* the creditor has accepted the consignation (*See Gamboa v. Tan, L-17076, Jan. 29, 1962*);
 - 2) or *before* there is a judicial declaration that the consignation has been properly made. (Here, the obligation and the accessory stipulations *remain*.)

(NOTE: The right is given the debtor because he still *owns* the thing; however, he bears the expenses. The co-debtors, guarantors, and sureties *cannot* object.)

- (b) As a matter of *privilege*:

When after consignation had been *properly* made (the creditor having accepted *or the court having declared it proper*), the *creditor authorizes* the debtor to withdraw the thing. (Art. 1261, Civil Code).

(7) Query

How can the creditor prevent the debtor from exercising the RIGHT to withdraw the thing consigned?

ANS.: By immediately accepting the consignation with or without reservations. If he accepts without reserving his right to further claims such as damages, this would be a case of WAIVER. (*Sing Juco v. Cuaycong*, 46 Phil. 81).

Art. 1261. If, the consignation having been made, the creditor should authorize the debtor to withdraw the same, he shall lose every preference which he may have over the thing. The co-debtors, guarantors and sureties shall be released.

COMMENT:

(1) Withdrawal by Debtor After Consignation Has Been Made

Under this Article, the consignation has already been made (that is, the creditor has accepted; or the court has approved the consignation). The withdrawal by the debtor is a matter of PRIVILEGE.

(2) Effects

- (a) The obligation *remains*.
- (b) The creditor loses any preference (priority) over the thing.
- (c) The co-debtors, guarantors, and sureties are RELEASED (unless they consented).

[NOTE: The co-debtors referred to are the solidary co-debtors, not the joint ones, for their liabilities are distinct. (8 Manresa 344).]

(NOTE: Regarding the solidary co-debtors, they are released only from the solidarity, *not from their own individual shares*, since unlike guarantors or sureties, the solidary co-debtors are in themselves PRINCIPAL debtors.)

Section 2

LOSS OF THE THING DUE

INTRODUCTORY COMMENT:

(1) What “Loss” Includes

“Loss” under this Section includes “impossibility of performance.”

(2) When Is There a Loss

- (a) when the object perishes (physically, it is destroyed)
- (b) when it goes out of commerce
- (c) when it disappears in such a way that
 - 1) its existence is unknown
 - 2) or it cannot be recovered. (*Art. 1189, No. 2, Civil Code*).

(3) What Impossibility of Performance Includes

- (a) physical impossibility
- (b) legal impossibility, which is either:
 - 1) *directly* caused as when prohibited by law
 - 2) or *indirectly* caused as when the debtor is required to enter a *military draft*
- (c) moral impossibility (impracticability). (*See Art. 1267, Civil Code*).

**Asia Bed Factory v. National Bed
Worker's Union, et al.
L-9126, Jan. 31, 1957**

FACTS: The company and its employees, in a collective agreement, agreed that “employees shall be provided with work on Sundays at time and a half (150% wages); and that in the event *no* work on Sundays is available thru *no fault of the employees*, they shall be paid the equivalent of their wages as if they had performed work for that day.” Three months later the Blue Sunday Law was passed, *prohibiting work* on Sundays. The employees contended they should nevertheless be paid on Sundays — since this prohibition by the law was *not their fault*.

HELD: The employees should not be paid because the company was prohibited by law to provide them work on Sundays. The company's duty to provide work on Sundays *was extinguished by the law*, so it is unfair to require it to pay the employees who after all would not be working on said days. Indeed, the obligation of the employer to furnish work became a legal impossibility.

**House v. Sixto de la Costa
68 Phil. 742**

FACTS: House sued Bush, and pending decision House obtained an attachment of Bush's property. Bush cancelled the attachment by posting a P2,000 bond, secured by a Surety Company. The bond stipulated that should Bush lose, Bush would return the property to the sheriff, and if Bush would not do so, the Surety Company would be liable.

Subsequently, by virtue of an agreement, Bush turned over to House the property previously attached, said property to be sold at a public auction. In said auction, House purchased the property. Later the pending case was terminated, and the trial court awarded House the sum of P2,000. House wanted the money from Bush, but since Bush could not pay, House sued the Surety Company for said amount. The trial court, presided over by Judge Sixto de la Costa, said that the Surety Company was not liable anymore because the bond could not be complied with (the giving of the property to the sheriff) since House was

already the owner of the property; and that it was House's act of purchasing the property that prevented compliance with the terms of the bond. House then brought this action. Decide.

HELD: The trial judge was correct. The Surety Company could have been held liable had not the petitioner House prevented compliance with the terms of the bond by his own act of purchasing the property. But since House did this, he cannot recover from said Surety Company.

Art. 1262. An obligation which consists in the delivery of a determinate thing shall be extinguished if it should be lost or destroyed without the fault of the debtor, and before he has incurred in delay.

When by law or stipulation, the obligor is liable even for fortuitous events, the loss of the thing does not extinguish the obligation, and he shall be responsible for damages. The same rule applies when the nature of the obligation requires the assumption of risk.

COMMENT:

(1) Two Kinds of Obligations "To Give"

An obligation to give may consist of an obligation:

- (a) to give a *generic* thing;
- (b) or to give a *specific* thing.

[NOTE: The first is NOT extinguished by loss or by a fortuitous event because "genus never perishes." (Art. 1263, Civil Code).]

(2) Effect of Loss on an Obligation to Deliver a Specific Thing

- (a) *General rule* — the obligation is extinguished.

[NOTE: The loss must be *after* the obligation has been incurred, because if the loss had been *PRIOR*, there would not be any subject matter and therefore there would *not* have been any obligation at all.]

[NOTE: If the mortgaged property is lost, the mortgagor being the owner of it bears the loss (*res perit domino*). He is, of course, still liable for the debt, since this obligation is monetary, and therefore may be said to be generic in character. (*Warner, Barnes & Co. v. Flores, L-12377, Mar. 29, 1961 and Lawyers Cooperative Publishing Co. v. Tabora, L-21263, Apr. 30, 1965*).]

(b) *Exceptions:*

The obligation is *not* extinguished in the following cases:

- 1) if the debtor is at fault (*Art. 1262, par. 1, Civil Code*);
- 2) when the debtor is made liable for a *fortuitous event* because:
 - a) of a *provision of law*;
 - b) of a *contractual stipulation*;
 - c) the nature of the obligation requires the *assumption of risk* on the part of the *debtor*.

(NOTE: Of course in the above-mentioned cases, the obligation to deliver the specific thing itself is extinguished for there is no more thing to be given. BUT said obligation is *converted* into a MONETARY OBLIGATION FOR DAMAGES. It is in this sense that we say that the “obligation” remains.)

(3) When Claim of Loss Must Be Made

If under the terms of a contract a claim for loss or damage (of goods carried on a vessel) must be made only *after* the date of discharge of the last package from the carrying vessel — will a claim *before* such date of discharge be regarded as premature and speculative?

It depends:

- (a) The claim is premature and speculative *if made without basis*.
- (b) The claim would, however, be proper if the claim was made *because of prior information or discovery of shortage of or*

damage to the goods. (New Hampshire Fire Insurance Co. v. Manila Port Service, et al., L-20938, Aug. 9, 1966; Switzerland General Insurance Co. v. Manila Railroad Co. & Manila Port Service, L-22150, Apr. 22, 1968 and Insurance Co. of North America v. Manila Port Service, L-24887, Apr. 22, 1968).

(4) Examples of Instances When the Law Requires Liability Even in the Case of a Fortuitous Event

- (a) when the debtor is in default (*mora*) (Art. 1165, Civil Code);
- (b) when the debtor has promised to deliver the same thing to two or more persons (parties) who do not have the same interest (Art. 1165, Civil Code);
- (c) when the obligation arises from a crime. (Art. 1268, Civil Code);
- (d) when a borrower (of an object) has lent the thing to another who is *not* a member of his own household (Art. 1942[4], Civil Code);
- (e) when the thing loaned has been delivered with *appraisal of the value*, unless there is a stipulation exempting the borrower from responsibility in case of a fortuitous event (Art. 1942[3], Civil Code);
- (f) when the *payee* in *solutio indebiti* is in *bad faith*. (Art. 2159, Civil Code).

Art. 1263. In an obligation to deliver a generic thing, the loss or destruction of anything of the same kind does not extinguish the obligation.

COMMENT:

(1) Effect of Loss on Obligation to Deliver a Generic Thing

The obligation continues to exist because a generic thing does not really perish (*genus nunquam perit* — “*genus* never perishes”).

(2) Exceptions

- (a) If the generic thing is delimited (like “50 kilos of sugar from my 1999 harvest” when such harvest is completely destroyed) (“*delimited generic thing*”).
- (b) If the generic thing has already been segregated or set aside, in which case, it has become specific.

(3) Monetary Obligations

An obligation to pay money, such as one under a pension plan, is generic. Here failure to raise funds is not a defense (*Phil. Long Distance Tel. Co. v. Jeturian*, L-7756, Jul. 30, 1955 and *Reyes v. Caltex*, 47 O.G. 1193), nor is it excused just because the debtor has *lost* certain *specific* property due to a fortuitous event. (*Ramirez v. Court of Appeals*, 52 O.G. 770).

Republic of the Philippines v. Jose Grijaldo
L-20240, Dec. 31, 1965

FACTS: A borrower obtained a loan from a bank. The loan was embodied in several promissory notes. As security, the borrower executed a chattel mortgage on his standing crops. Said crops were, however, subsequently destroyed by the Japanese forces during the last war. **Issue:** Is the borrower still liable for the loan despite the destruction of the crops by someone else?

HELD: Yes, the borrower is still liable, for his obligation was *not* to deliver determinate things (the crops) but to deliver a *generic* thing (money). The amount of money representing the value of the crops, with interest, cannot be said to have been lost, for the account can still be paid from sources *other than* the mortgaged crops.

Art. 1264. The courts shall determine whether, under the circumstances, the partial loss of the object of the obligation is so important as to extinguish the obligation.

COMMENT:**Effect of Partial Loss**

In certain cases, *partial* loss may indeed be equivalent to a complete loss, such as the loss of a specific fountain pen *minus*

the cover. In other cases, the loss may be insignificant. Hence, judicial determination of the effect is needed.

Art. 1265. Whenever the thing is lost in the possession of the debtor, it shall be presumed that the loss was due to his fault, unless there is proof to the contrary, and without prejudice to the provisions of Article 1165. This presumption does not apply in case of earthquake, flood, storm, or other natural calamity.

COMMENT:

(1) Presumption That Loss Was Due to Debtor's Fault

Note that the debtor is presumed to be at fault. If a person for example is entrusted with several heads of cattle and he cannot account for some missing ones, he is presumed to be at fault. (*Palacio v. Sudario*, 7 Phil. 275; see *Malayan Insurance Co., Inc. v. Manila Port Service*, L-26700, May 15, 1969).

(2) When Presumption Does Not Apply

The presumption of fault does not apply in the case of a natural calamity. Although fire is not a natural calamity, if a tenant is able to prove that the fire caused in his apartment was purely ACCIDENTAL, he is NOT liable. (*Lizares v. Hernaez & Alunan*, 40 Phil. 981).

Art. 1266. The debtor in obligations to do shall also be released when the prestation becomes legally or physically impossible without the fault of the obligor.

COMMENT:

(1) Loss in Personal Obligations

This Article refers to a case when compliance of a personal obligation becomes, *without* the debtor's fault —

- (a) a *legal* impossibility;
- (b) or a *physical* impossibility.

(2) When the Impossibility Must Exist

The impossibility must be AFTER the constitution of the obligation. If it was before, there is nothing to extinguish. (8 *Manresa* 354). (Note the word “becomes”). Hence, if the performance was impossible right at the start, the obligation must be regarded as VOID.

(3) Examples of Impossibility

(a) *Legal impossibility*

The furnishing of work on Sundays when the same is prohibited by law (*Asia Bed Factory v. National Bed Worker's Union, et al.*, L-9126, Jan. 31, 1957); refusal of the government to issue a building permit. (*Tabora v. Lazatin*, L-5245, May 29, 1953).

(b) *Physical impossibility*

To install a motor in a ship that was lost after the perfection of the contract but prior to such installation. (See *Milan v. Rio y Olabarrieta*, 45 Phil. 718).

Milan v. Rio y Olabarrieta 45 Phil. 718

FACTS: A sold a half-interest in his motorboat to B. It was agreed that the price to be paid by B would be used in installing a motor on the vessel. Later, the vessel was destroyed by a fortuitous event. **Issue:** Is B's obligation to pay the price extinguished?

HELD: B must still pay because his obligation to pay is generic. This is so even if there is no more use of installing the motor since the boat has already been destroyed by the fortuitous event. It should be noted here that it is not the paying that has become impossible (for indeed, it still is); it is merely the act to be performed after the paying that has become impossible. Thus, the obligation or prestation (to pay) remains.

(4) Effect of Subjective Impossibility

If the act is *subjectively* impossible (for the debtor himself) but otherwise objectively possible (for all others), is the obligation extinguished?

ANS.: It depends. Usually the obligation subsists (*Reyes v. Caltex*, 47 O.G. 1193), unless personal considerations are involved such as when only a *particular* company is prohibited by law to furnish work on a certain day.

(5) Effect of Loss Thru a Fortuitous Event in Reciprocal Obligations

(a) *General rule:* The obligation that was not extinguished by the fortuitous event remains. (*Example:* If after perfection a building that was sold is destroyed by lightning, the buyer must still pay, for he bears the loss even if the building had not yet been delivered to him.) (*See Art. 1191, Civil Code*).

(b) *Exceptions:*

Some exceptions are provided for by the law, such as:

- 1) In the case of lease — If the object is destroyed, both the lease and the obligation to pay rent are extinguished. (*See Art. 1655, Civil Code*).
- 2) In contracts for a piece of work — Here, the worker or contractor cannot successfully ask for the price if the thing be lost by a fortuitous even prior to delivery. Note here that the risk is on the worker. (*See Art. 1717, Civil Code*).

(6) Partial Impossibility

Art. 1264 applies to *partial impossibility*.

Art. 1267. When the service has become so difficult as to be manifestly beyond the contemplation of the parties, the obligor may also be released therefrom, in whole or in part.

COMMENT:

(1) Effect of Difficulty Beyond the Parties' Contemplation

This Article refers to moral impossibility or impracticability due to change of certain conditions (*rebus sic stantibus* — a treaty or agreement remains valid only if the *same* conditions

prevailing at the time of contracting *continue to exist at the time of performance*).

[NOTE: This is also referred to as the doctrine of “the frustration of the commercial object” (*Re Badische Co. [1921] 2 Ch. Eng 331*), “frustration of enterprise.” (*Reyes and Puno, Outline of Civil Law, Vol. IV, p. 239, citing Corbin on Contracts, Vol. 6, pp. 1353-1361*).]

(2) Non-Applicability to Real Obligations

It will be noted that Art. 1267 speaks of a “service” — a *personal obligation*. Thus, real obligations (“to give”) are not included within its scope. If for example a lease contract is entered into for say 20 years at a fixed rental per month, would the lessor be justified in increasing said rent to 800% if the taxes or assessments are also increased by 800%? It is submitted that in view of the existence of the contract, no such increase can be effected without the lessee’s consent. After all, the increase in taxes or in assessments cannot be said to be “beyond the contemplation of the parties.” If upon the other hand the lessee will have his own house constructed in say 5 years, and will, thus, not need the premises anymore, he will necessarily still be bound by the contractual agreement.

(3) Comment of the Code Commission

“The general rule is that impossibility of performance releases the obligor. However, it is submitted that when the service has become so difficult as to be manifestly beyond the contemplation of the parties, the *court* should be authorized to release the obligor in whole or in part. The intention of the parties should govern and if it appears that the service turns out to be so difficult as to have been beyond their contemplation, it would be doing violence to that intention to hold the obligor still responsible.” (*Report of the Code Commission, p. 133*).

(4) Examples of Moral Impossibility

The duty to construct a railroad when such construction was possible but *very dangerous to life* and property, is excused by the law; therefore, failure to grind sugar cane in view of the non-construction of the railroad does NOT give rise to damages.

(8 *Manresa* 355 and *Labayen v. Talisay-Silay Milling Co.*, 52 *Phil.* 440). However, if instead of extreme danger there is only proved the existence of *mere inconvenience, unexpected impediments, or increased expenses*, the same would not be enough to relieve a debtor from his “bad bargain.” (*Castro, et al. v. Longa*, 89 *Phil.* 581).

[NOTE: For Art. 1267 to apply, the following requisites must concur:

- (a) The *service* must become so *difficult* that it was manifestly beyond the contemplation of BOTH parties. (*Art. 1267*). Thus, it is not enough that neither party actually anticipated or foresaw the difficulty; the difficulty *could not POSSIBLY have been anticipated or foreseen*.
- (b) One of the parties must ask for relief. (*TS, May 17, 1941*).
- (c) The object must be a *future service* with *future unusual* change in conditions. (Naturally, an *aleatory* contract or one dependent on chance, in view of the risks *being* foreseen, does not come under the scope of *Art. 1267*.)]

Art. 1268. When the debt of a thing certain and determinate proceeds from a criminal offense, the debtor shall not be exempted from the payment of its price, whatever may be the cause for the loss, unless the thing having been offered by him to the person who should receive it, the latter refused without justification to accept it.

COMMENT:

(1) Effect of Loss in Criminal Offenses

- (a) This Article gives one instance where a fortuitous event does *not* extinguish the obligation.
- (b) *Exception:* When the creditor (the offended party in the crime) is in *MORA ACCIPIENDI*.

(2) Illustrative Questions

- (a) A commits the crime of theft, and is asked to return the car stolen to its owner B. If, before the car is delivered to

B, it is destroyed by fortuitous event, is *A*'s liability extinguished?

ANS.: No, *A*'s liability is not extinguished.

Reason: *A*'s obligation to deliver the car arose from a criminal offense, and in such a case, the rule is, he is liable even if the loss occurs because of a fortuitous event.

- (b) Suppose in Problem (a), *A* had previously asked the owner to accept the car, but the owner without any justifiable reason refuses to accept the car, do you believe *A* to still be responsible if, let us say, the car is lost later by a fortuitous event?

ANS.: In this case, the criminal could no longer be liable because here the creditor is in *mora accipiendi*. This is the exception to the rule.

- (c) If the creditor refuses to accept the thing due from the criminal, what should the latter do?

ANS.: The criminal may either consign the thing or else keep the thing in his possession. If he does the latter thing, he is still obliged to care for it with due diligence, but this time he will not be liable if the thing is lost through a fortuitous event. (2 *Manresa* 361).

Art. 1269. The obligation having been extinguished by the loss of the thing, the creditor shall have all the rights of action which the debtor may have against third persons by reason of the loss.

COMMENT:

(1) Transfer of Rights from the Debtor to the Creditor in Case of Loss

Example:

S is obliged to deliver his car to *B*. But *X* destroys the car. *B* has a right to sue *X*. The right is given to *B* instead of *S* because otherwise *S* would *unduly profit* in that he will gain two

things: *first*, his obligation to give the car or its value is already extinguished; *second*, he would be allowed to recover from *X*. It is obvious that *S* must *not* unduly profit at the expense of *B*.

(2) “Rights of Action”

“Rights of action” include the insurance indemnity that may have been received. (*See Urrutia & Co. v. Baco River Plantation Co.*, 26 Phil. 632).

Urrutia & Co. v. Baco River Plantation Co. 26 Phil. 632

FACTS: A vessel collided with another vessel. The first vessel was at fault, but it sank. However, the owner of the vessel collected insurance. **Issue:** Is the insurance money liable for the damages sustained by the second vessel?

HELD: Yes. “The vessel lost was insured, and the defendant collected the insurance. That being the case, the insurance money substitutes the vessel, and must be used, so far as necessary, to pay the judgment rendered in this case.”

Section 3

CONDONATION OR REMISSION OF THE DEBT

Art. 1270. Condonation or remission is essentially gratuitous, and requires the acceptance by the obligor. It may be made expressly or impliedly.

One and the other kinds shall be subject to the rules which govern inofficious donations. Express condonation shall, furthermore, comply with the forms of donation.

COMMENT:

(1) ‘Remission or Condonation’ Defined

It is “the gratuitous abandonment by the creditor of his right.” (4 *Sanchez Roman* 422).

(2) Example

Gloria owes Edgardo P5.00. When the debt matured Edgardo told Gloria that she need not *pay* the debt since he was condoning it. Gloria, in turn, expressed her gratitude. Here, the debt has been extinguished by remission.

(3) Essential Requisites for Remission

- (a) There must be an *agreement* (since acceptance of the offer is required). (*Art. 1270*).
- (b) The parties must be *capacitated* and must *consent* (therefore, it is beyond the power of the courts or of Congress to condone interest unless the creditor *consents*). (*Banez v. Young, L-4635, Oct. 27, 1952*).
- (c) There must be *subject matter* (object of the remission — otherwise, there would be nothing to condone).
- (d) The cause or consideration must be *liberality* (for remission is *ESSENTIALLY GRATUITOUS*). (Otherwise, the act may be a *dation in payment*, or a *novation*, or a *compromise*.) (*8 Manresa 329-330*).
- (e) The obligation remitted must have been *demandable* at the *time of remission* (otherwise, the remission is useless). (*8 Manresa 330*).
- (f) The remission must *not be inofficious* (otherwise, it would be *reducible*, so that the legitimes of the compulsory heirs would not be impaired).

QUERY: The law mentions “inofficious donations,” but does not refer to the other grounds for revocation of donations such as ingratitude. Now then, may the remission be revoked on said other grounds?

ANS.: Yes, because remission is essentially a donation (*Castan*), despite the exclusive mention of “inofficious.”

- (g) *Formalities of a donation* are required in the case of an express (not implied) remission. (*Art. 1270*).

Example: A remission of an obligation to give land must be in a public instrument in order to be valid. (*Art. 749, Civil Code*).

QUERY: May an express remission *defective* in form be considered an *implied* remission?

ANS.: No, otherwise, the requirement of the law on express remission would be rendered useless. Thus, an express remission, not made in due form, cannot affect the creditor if it is *withdrawn in due time*. It would affect him only when *new acts of waiver* confirm the express purpose of the former, as one of the bases on which tacit or implied remission may rest. (8 *Manresa* 344).

(**NOTE:** If remission is made in a will, it is essential that the will be **VALID** extrinsically, and **PROBATED**. After all, such a remission is made **EXPRESSLY**. The will, be it remembered, actually partakes of a donation *mortis causa*.)

- (h) Waivers or remissions *are not to be presumed generally*. They must be *clearly and convincingly shown*, either by express stipulation, or by acts admitting of no other reasonable explanation. (*Arrieta v. NARIC, L-15645, Jan. 31, 1964*).

(4) Classes of Remission

- (a) As regards its *effect or extent*:
 - 1) total
 - 2) partial (only a portion is remitted or the remission may refer only to the *accessory obligations*)
- (b) As regards its *date of effectivity*:
 - 1) *inter vivos* (during life)
 - 2) *mortis causa* (after death)

(This must have the formalities of a will and the will must be *probated*.)
- (c) As regards its *form*:
 - 1) implied or tacit (this requires no formality) (*conduct is sufficient*)
 - 2) express or formal (this requires the formalities of a donation if *inter vivos*; of a will or codicil if *mortis causa*)

(5) Remission Must Be Gratuitous**Lyric Film Exchange v. Cowper
(C.A.) 36 O.G. 1642**

FACTS: A bought furniture from B on credit. On the date of payment B told A he would condone the debt provided that A would return the furniture which has been furnished him. A agreed. Is there remission here?

HELD: The Court of Appeals said that this is, strictly speaking, not the satisfaction of an obligation but the condonation or remission of a debt.

(*NOTE:* This should be really considered a compromise, not a remission for it is *not gratuitous*.)

(6) Effect if Remission Is Not Accepted by the Debtor

This would not be remission; however, if the creditor does not really collect within the Statute of limitations (period of prescription), the debt may be said to have been extinguished by PRESCRIPTION.

(7) What Remission Includes**Francisco Puzon v. Marcelino Gaerlan, et al.
L-19571, Dec. 31, 1965**

FACTS: A conjugal two-storey building, owned by a husband and wife living separately from each other, was leased in favor of certain tenants, but the contract of lease stipulated that the rents would be paid to the husband alone. The wife sued for part of said rentals. In the course of the trial, a compromise was agreed upon between the spouses to the effect that the wife would pay the husband P35,000 in consideration of a *waiver* made by the husband to any right in said property and to any accounting of the rentals the property would earn. The compromise was then approved by the court. *Issue:* Does the waiver to this property dissolve the conjugal partnership between the spouses?

HELD: No, for the waiver applies only to the property mentioned in the agreement. With reference to all *other* conjugal

properties, as well as future properties, the conjugal partnership still remains.

(8) When Waiver or Abandonment Is Defective

**Jovencio Luansing v. People of the
Philippines & Court of Appeals
L-23289, Feb. 28, 1969**

FACTS: In a criminal action for seduction, the offended party expressly reserved the right to file a separate civil action. The CFI (now RTC) found the accused guilty, and imposed *civil liabilities*. No motion for reconsideration was filed by the offended party. **Issue:** Was the imposition of civil liability proper, despite the reservation?

HELD: No, the imposition of the civil liability was *not proper* because:

- (a) there was the *reservation* as to the civil aspect;
- (b) the mere failure to file a motion for reconsideration does *not* necessarily result in waiver or abandonment. Abandonment requires a more convincing quantum of evidence than mere forbearance to actually file the civil action, especially when we consider the fact that the same could be filed even after the decision in the criminal case had been rendered;
- (c) *proof* should be given with respect to the amount.

Art. 1271. The delivery of a private document evidencing a credit, made voluntarily by the creditor to the debtor, implies the renunciation of the action which the former had against the latter.

If in order to nullify this waiver it should be claimed to be inofficious, the debtor and his heirs may uphold it by proving that the delivery of the document was made in virtue of payment of the debt.

COMMENT:**(1) Effect of Delivery of Private Document Evidencing the Credit**

The Article speaks of a “private document,” not a public one because in the case of the latter, a copy is easily obtainable, being a public record. Note that with the delivery of the private instrument, a remission or renunciation is *presumed*.

(2) Example

Steffi made a promissory note in favor of Agassi in the amount of P100 million. After some time, Agassi voluntarily delivered the promissory note to Steffi without collecting the P100 million. Steffi is now in possession of said note. There is a *disputable* presumption that there has been a remission. The presumption is merely disputable and not conclusive because it may be that the instrument was delivered only for examination by Steffi or for collection. (*See Lopez Vito v. Tambunting, 33 Phil. 226*).

(3) Implied Remission

It should be noted that Art. 1271 gives us an example of an *implied remission*.

(NOTE: The voluntary destruction by the creditor of the instrument is likewise another form of implied remission.)

[NOTE: But the mere fact that the creditor has omitted a certain debt or the name of the debtor from an inventory made by him does not imply a tacit remission. (*TS, Nov. 19, 1915*).]

(4) Falsehood Not Allowed

It must *not* be thought that the second paragraph allows a falsehood. The debtor and his heirs now claim that the instrument was delivered not because of payment *BUT only when indeed there was a payment*. The law must not be construed to allow an immoral actuation.

(5) Conflict of Presumption

It should be noted likewise that as between the presumption of remission and the presumption of payment, the first (remission) ordinarily prevails.

Art. 1272. Whenever the private document in which the debt appears is found in the possession of the debtor, it shall be presumed that the creditor delivered it voluntarily, unless the contrary is proved.

COMMENT:**(1) Presumption of Voluntary Delivery**

- (a) While Art. 1271 gives a *presumption of remission*, Art. 1272 gives a *presumption of voluntary delivery*.
- (b) Note again here that the law speaks of a private *document*.
- (c) The presumption is disputable or *prima facie*, for the law itself says “until the contrary is proved.” (Art. 1272; see *Lopez Vito v. Tambunting*, 33 Phil. 226).

Lopez Vito v. Tambunting
33 Phil. 226

FACTS: A owed B a sum of money. B sent a receipt signed by him to A through a collector, who was supposed to collect a debt. A did not pay, however, although he kept the receipt. The creditor (B) was able to prove that the only reason he had sent the receipt was to collect the money. *Issue:* Is there remission here?

HELD: No, there is no remission here; the creditor has been able to prove the real reason why the debtor had in his possession the receipt. Hence, the presumption of remission has been overcome.

(2) Rule if the Instrument of Credit Is Still in Creditor's Hands

If the instrument of credit is still in the hands of the creditor, this is evidence that the debt has not yet been paid, unless

the contrary be fully proved. (*Toribio v. Fox*, 34 Phil. 913). To rebut the presumption, ordinarily, a receipt of payment must be presented. (*Pinon & Manalac v. Osorio*, 30 Phil. 365).

(3) Presumption in Joint or Solidary Obligations

Effect if the obligation is *joint*, or if it is *solidary*.

Example: A and B owe C P100,000, evidenced by a private document.

- (a) If the private document is found in the possession of A, who is a *joint* debtor, what is the presumption?

ANS.: The presumption is that only A's debt has been remitted.

Reason: A's debt is not P100,000 but only P50,000; in other words, his debt is really distinct from B's debt.

- (b) If the private document is found in the possession of A who is a *solidary* debtor, what is the presumption?

ANS.: Since this is a *solidary* obligation, the presumption is that the whole obligation (not merely A's share) has been remitted.

- (c) In both cases, may the presumption be rebutted?

ANS.: Yes, the presumption in both cases can be overcome by superior contrary evidence. (8 *Manresa* 379).

Art. 1273. The renunciation of the principal debt shall extinguish the accessory obligation; but the waiver of the latter shall leave the former in force.

COMMENT:

(1) Renunciation of Principal Extinguishes Accessory, But Not Vice-Versa

This follows the rule of "accessory follows the principal."

(2) Example

A remission of the penalty does *not* remit the principal

obligation, but if the principal debt is condoned, the penalty is also condoned.

Art. 1274. It is presumed that the accessory obligation of pledge has been remitted when the thing pledged, after its delivery to the creditor, is found in the possession of the debtor, or of a third person who owns the thing.

COMMENT:

(1) Remission of Pledge

- (a) Note here that only the accessory obligation of pledge is presumed remitted. The principal obligation (the loan) remains in force.
- (b) The presumption is only *disputable*, for the debtor or the third person may be in possession of the property by theft or because it had been sent for repairs, or for similar causes.

(2) Reason for the Presumption

It is essential in pledge that the thing be delivered to the creditor, or to a third person by common agreement.

(3) Possession by a Third Person

The law says “or of a third person who owns the thing.” Therefore, if the third person does not own the thing, the presumption does not arise. As a matter of fact, the stranger may just have found it or it may have been delivered to him only for safekeeping.

Section 4

CONFUSION OR MERGER OF RIGHTS

Art. 1275. The obligation is extinguished from the time the characters of creditor and debtor are merged in the same person.

COMMENT:**(1) 'Merger or Confusion' Defined**

It is the meeting in one person of the qualities of creditor and debtor with respect to the same obligation. (*94 Sanchez Roman 421*).

(2) Reason or Basis for Merger

If a debtor is his own creditor, enforcement of the obligation becomes absurd, since one cannot claim against himself. (*8 Manresa 349*).

(3) Requisites of a Valid Merger

- (a) It should take place between the principal debtor and creditor. Therefore, confusion of the creditor with the person of the guarantor does not extinguish the principal obligation. (*Art. 1276*). Of course, in a case like this, the accessory obligation of guaranty is extinguished.

Therefore also, there can be *no* confusion or merger if the debtor and creditor represent (*different*) juridical entities even if the officers of both are the SAME. (*Kapisanan ng mga Manggagawa sa MRR v. Credit Union, etc., L-14332, May 20, 1960*).

- (b) The merger must be clear and definite. (*Testate Estate of Mota v. Serra, 47 Phil. 464*).
- (c) The very obligation involved must be the same or identical (because if the debtor acquires certain rights from the creditor with respect to *other* things, there is no merger). (*Testate Estate of Mota v. Serra, 47 Phil. 464*).

(NOTE: If an heir is a debtor of the deceased, merger does not necessarily follow, for other creditors may be prejudiced.)

(4) Example of Merger

A makes a check payable to bearer, and hands the check to C, who hands it to D who finally hands it to A. Here A owes himself. This is a clear case of merger, and hence the obligation of A is extinguished.

(5) Effect of Transfer of Rights

Mere transfer to a third person of *rights* belonging to both the debtor and the creditor BUT *not* the credit as against the debt does not result in merger. (*Testate Estate of Mota v. Serra*, 47 Phil. 464).

Example:

A and B were co-owners of a piece of property worth P1,000,000. For some repairs thereon, B paid P200,000. Because they were co-owners, A had to share in said expenses, and so A owed B P100,000. A sold his share in the property to C and B also sold his share in the property to C. Later B brought this action to recover P100,000 from A. A claimed that since C is now the owner of the property, C *owes himself*, and therefore said merger had extinguished his debt to B. Should A pay B?

ANS.: Yes, A should pay B, since there was really no merger here. What had been sold to C were the half shares of each of the co-owners, or P500,000 worth of property from each. C did not acquire the indebtedness of P100,000 for the repairs, hence there can be no merger with reference to that debt. (As implied from the case of *Testate Estate of Mota v. Serra*, 47 Phil. 464).

(6) Extinction of Real Rights

Real rights, such as usufruct over property, may be extinguished by merger when the *naked owner* himself become the *usufructuary*.

(NOTE: This is also denominated “consolidation of ownership.”)

Example:

A had two brothers B and C. A gave a parcel of land to B in *usufruct* (right to the use and right to the fruits), and the same parcel to C in naked ownership. If later C donates the naked ownership of the land to B, B will now have the full ownership (his ownership is consolidated), and it is as if *merger* had resulted.

(7) Revocability of Confusion or Merger

If the reason for the confusion *ceases*, the obligation is REVIVED.

(8) Effect if Mortgagee Becomes the Owner of the Mortgaged Property

If the mortgagee becomes the owner of the property that had been mortgaged to him, the mortgage is naturally extinguished, but the principal obligation may remain. (*See Yek Ton Lin Fire v. Yusingco, 64 Phil. 1062*).

Example:

I borrowed P1,000,000 from my brother, and as security, I mortgaged my land in his favor. Later I sold the land to him. The mortgage is extinguished but I still owe him P1,000,000.

(NOTE: Had he assigned his credit of P1,000,000 to a friend and the friend assigned the credit to me, both the principal obligation and the mortgage are extinguished.)

Art. 1276. Merger which takes place in the person of the principal debtor or creditor benefits the guarantors. Confusion which takes place in the person of any of the latter does not extinguish the obligation.

COMMENT:

(1) Effect of Merger on Guarantors

“Accessory follows the principal” (the guaranty being considered the accessory obligation); hence, if there is merger with respect to the principal debt, the guaranty is extinguished; note, however, the second sentence of the Article.

(2) Examples

- (a) *A owes B P700,000, guaranteed by C. B assigns his credit to X. X assigns the credit to Y. Y assigns the credit to A. A’s obligation is extinguished and C is released from his obligation as guarantor.*
- (b) *A owes B P700,000, guaranteed by C. B assigns his credit to X. X assigns his credit to Y. Y assigns his credit to C, the guarantor. Does A still have to pay C?*

ANS.: Yes. However, the contract of guaranty is extinguished, but not A’s obligation to pay the P700,000.

(3) Problems

- (a) A owes B with C's land given as security by way of mortgage. Later B becomes the owner of one-third of C's land (said one-third share having been sold or donated to him by C). Is the *mortgage* extinguished?

ANS.: The mortgage is extinguished regarding B's one-third share of the land because of merger. This is evident because otherwise, if the debt is not paid, B would hold *his own property* as security and this would be absurd. However, the mortgage continues to subsist on the *two-thirds* of the land still belonging to C.

- (b) Suppose in the preceding problem, B became the owner of the whole of C's land, what happens to the mortgage?

ANS.: For the same reason hereinabove given, the mortgage is completely extinguished. However, does A's debt in favor of B still exist? The answer is evidently YES, for extinguishment of the accessory obligation does not by itself extinguish the principal obligation which is the *loan*. This time, however, it would be a case of a *loan without security*.

Art. 1277. Confusion does not extinguish a joint obligation except as regards the share corresponding to the creditor or debtor in whom the two characters concur.

COMMENT:**Merger in Joint Obligations**

A and B jointly owe C P1,000,000. If C assigns the entire credit to A, A's share is extinguished, but B's share remains. In other words, B would still owe A the sum of P500,000. In a joint obligation, the debts are distinct and separate from each other.

Section 5**COMPENSATION**

Art. 1278. Compensation shall take place when two persons, in their own right, are creditors and debtors of each other.

COMMENT:**(1) ‘Compensation’ Defined**

- (a) “It is a sort of *balancing* (*cum ponder* — ‘to weigh together’) between two obligations; it involves a figurative operation of weighing two obligations simultaneously in order to extinguish them to the extent in which the amount of one is covered by the other.” (8 *Manresa* 366).
- (b) It is the extinguishment in the *concurrent* amount of the obligations of those persons who are reciprocally debtors and creditors of each other. (*Castan, Derecho, Civil Español*, p. 61).

(2) Usefulness of Compensation

In effect, it is a specie of *abbreviated payment* which gives to each of the parties a double advantage:

- (a) “facility of payment;
- (b) guaranty for the effectiveness of the credit because if one of the parties pays even without waiting to be paid by the other, he could easily be made a victim of fraud or insolvency.” (*Castan, Derecho, Civil Español*, pp. 61-62).

Indeed, it is *simplified* or *abbreviated payment*, because the two debts are extinguished without requiring the transfer of money or property from one party to the other. (*TS, May 11, 1926*).

(NOTE: In banking operations, a “clearing house” takes care of compensation in banking accounts.)

(3) ‘Compensation’ Distinguished from ‘Payment’

- (a) While payment must be complete and indivisible as a rule, in compensation, partial extinguishment is always permitted. (*See 8 Georgi, Teoria de las Obligaciones*, pp. 24-25).
- (b) While payment involves action or delivery, *true* compensation (legal compensation) takes place by operation of law.

(4) ‘Compensation’ Distinguished from ‘Merger’

- (a) As to the number of persons:

In confusion, there is only one person in whom is merged the qualities of creditor and debtor.

In compensation, there must be two persons who are mutually creditor and debtor to each other.

- (b) As to the number of obligations:

In confusion, there can be only one.

In compensation, there must be two.

(5) ‘Compensation’ Distinguished from ‘Counterclaim’ or ‘Set-off’

- (a) “A set-off or a counterclaim must be pleaded to be effectual, whereas compensation takes place by mere operation of law, and extinguishes reciprocally the two debts as soon as they exist simultaneously, to the amount of their respective sums.” (11 *La Ann*, 520; 16 *La Ann*, 181; cited in the case of *Yap Unki v. Chua Jamco*, 14 *Phil.* 602).
- (b) A set-off or counterclaim works as a sort of *judicial compensation*, provided that the requirements of the Rules of Court, particularly on Counterclaims and/or Cross-claims are observed. (See *Sec. 2, Rule 9, Revised Rules of Court*).

(6) Kinds or Classes of Compensation

- (a) According to its *effect or extent*:
- (1) *Total* — if both obligations are completely extinguished because they are of the same or equal amounts.
 - (2) *Partial* — when a balance remains (hence, there is a *partial* compensation in the *larger* of the two *debts*).
- (b) According to its *origin or cause*:
- 1) *Legal* — this takes place by operation of law, and need not be pleaded.
 - 2) *Voluntary or conventional* — this is due to the agreement of the parties.

- 3) *Judicial* (also termed “set-off”) — this must be pleaded; it can be made effective only by an order from the court. (*See Yap v. Chua Jamco, 14 Phil. 602; See also Art. 1283, Civil Code*).
- 4) *Facultative* — here, one of the parties has the choice of *claiming* the compensation or of opposing it (perhaps because not all the requisites of legal compensation are present).

Example of Facultative Compensation:

A owes B P1 million demandable and due on Jan. 12, 2004. B owes A P1 million demandable and due *on or before* Jan. 31, 2004. On Jan. 12, 2004 B, who was given the benefit of the term, may *claim* compensation because he could then choose to pay his debt on said date, which is “on or before Jan. 31, 2004.” If, upon the other hand A claims compensation, B can properly *oppose* it because B could not be made to pay until Jan. 31, 2004.

(NOTE: It should be observed that while facultative compensation is *unilateral* and does not require mutual agreement, *voluntary or conventional compensation* requires *mutual consent*.)

(7) When Compensation Cannot Exist

Under the law, the two persons concerned are creditors and debtors of each other; therefore, a debtor of a corporation cannot compensate his debt with his *share of stock in the corporation*, since the corporation is not considered his debtor. (*Garcia v. Lim Chu Sing, 59 Phil. 562*). It would have been *different* had the corporation really been his debtor as when he had paid it a sum *greater* than the value of his shares. (*Brimo v. Goldenberg and Co., Inc., 40 O.G. [6th S] No. 10, p. 199*).

Garcia v. Lim Chu Sing 59 Phil. 562

FACTS: Defendant is the owner of shares of stock of the Mercantile Bank of China amounting to P10,000. Later, the defendant borrowed money from the Bank amounting to P9,605.17

with interest thereon at 6% *per annum*. The debt was to be paid in installments. One of the conditions of the debt contract is that in case of the debtor's default in the payment of any of the installments as they become due, the entire amount or the unpaid balance thereof will become due and payable on demand. The defendant defaulted in the payment of several installments and plaintiff brought this action to recover the unpaid balance. The defendant pleaded compensation. *Issue*: Can defendant's debt be compensated with the shares of stock he owns?

HELD: There can be no compensation because regarding the shares of stock, there *is no* relationship of *debtor and creditor*. *Said the Supreme Court*:

"A stockholder's indebtedness to a banking corporation cannot be compensated with the amount of his shares in the same institution, there being no relation of creditor and debtor with regards to such shares."

"According to the weight of authority, a share of stock or the certificate thereof is not an indebtedness to the owner nor evidence of indebtedness, and, therefore, it is not a credit. (14 *Corpus Juris*, p. 388, Sec. 511). Stockholders, as such, are not creditors of the corporation. (14 *Corpus Juris*, p. 848, Sec. 1289). It is the prevailing doctrine of the American courts, repeatedly asserted in the broadest terms, that the capital stock of a corporation is a trust fund to be used more particularly for the security of the creditors of the corporation, who presumably deal with it on the credit of its capital stock. (14 *Corpus Juris*, p. 383, Sec. 505). Therefore, the defendant-appellant Lim Chu Sing, not being a creditor of the Mercantile Bank of China, although the latter is a creditor of the former, there is no sufficient ground to justify a compensation." (*Acuña Co Chongco v. Dievas*, 12 *Phil.* 250)."

Brimo v. Goldenberg and Co., Inc.
69 Phil. 502

FACTS: Brimo was a stockholder and a treasurer of a corporation. Brimo paid a sum greater than the value of his shares, and was therefore a creditor to that extent (the excess, but not as to the value of the shares, for here, he is not a creditor). As

treasurer, Brimo owed the corporation a certain sum. *Issue:* May Brimo's credit be compensated with his indebtedness as treasurer?

HELD: Yes, because both are debts and credits.

Francia v. IAC
GR 67649, Jun. 28, 1988

Internal revenue taxes cannot be the subject of compensation. Reason: government and taxpayer "are not mutually creditors of each other" under Art. 1278 of the Civil Code and a "claim for taxes is not such a debt, demand, contract or judgment as is allowed to be set-off."

There can be no offsetting of taxes against the claims that the taxpayer may have against the government. A person cannot refuse to pay a tax on the ground that the government owes him an amount equal to or greater than the tax being collected. The collection of a tax cannot await the result of a lawsuit against the government.

Tan v. Mendez
GR 138669, Jun. 6, 2002

FACTS: The memorandum shows that some unencashed checks returned to respondent to allegedly offset the dishonored check were from the Baao ticket sales which are separate from the ticket sales of respondent. Here, respondent only acted as an intermediary in remitting the Baao ticket sales.

HELD: Because of respondent's role as mere intermediary, he is not a debtor of petitioners. No compensation can take place between petitioners and respondent as the latter is not a debtor of the former insofar as the two checks representing collections from the Baao ticket sales are concerned.

Carlos v. Abelardo
GR 146504, Apr. 9, 2002

FACTS: Defendant-husband in invoking the defense of compensation argues that if indeed he and his spouse are indebted to plaintiff, the latter could have applied their share

in the proceeds or income of the corporation to the concurrent amount of the alleged loan, instead of giving the amount of P3 million to them. *Issue*: Is this argument tenable?

HELD: This argument is untenable. As Art. 1278 indicates, compensation is a sort of balancing between two obligations. In the instant case, compensation is a sort of balancing between two obligations. In the instant case, plaintiff and defendant-husband are not debtors and creditors of each other. Even granting that the defendant-husband's claim to the profits of the corporation is justified, still compensation cannot extinguish his loan obligation to plaintiff because under such assumption, the defendant is dealing with the corporation and not with the plaintiff in his personal capacity. Hence, compensation cannot take place.

Art. 1279. In order that compensation may be proper, it is necessary:

(1) That each one of the obligors be bound principally, and that he be at the same time a principal creditor of the other;

(2) That both debts consist in a sum of money, or if the things due are consumable, they be of the same kind, and also of the same quality if the latter has been stated;

(3) That the two debts be due;

(4) That they be liquidated and demandable;

(5) That over neither of them there be any retention or controversy, commenced by third persons and communicated in due time to the debtor.

COMMENT:

(1) Legal Compensation or Compensation by Operation of Law

The requisites enumerated under Art. 1279 are those for LEGAL compensation; *voluntary* compensation in general requires *no* requisite except that the agreement be voluntarily and validly entered into.

(2) Affirmative Requisites for Legal Compensation

Items (1), (2), (3) and (4) of Art. 1279 are the affirmative requisites.

(3) Negative Requisites for Legal Compensation

- (a) Over *neither* of the debts must there be any *retention* or controversy *commenced* by *third persons* and communicated in due time to the debtor. (*Par. 5, Art. 1279*). Thus, there can be no legal compensation when one's claim against another is still the subject of *court litigation*. (*Mialhe v. Halili, L-16587, Oct. 31, 1962*).
- (b) There must have been no *waiver* of the compensation (such waiver *could have been validly agreed* on, since this would not be contrary to public policy). (*Manresa*).
- (c) The compensation of the debts *must* not have been prohibited by law. The compensation of the following are prohibited:
 - 1) debts arising from a *depositum* (except bank deposits, which are by law considered as loans to the bank) (*Art. 1287; Art. 1980, Civil Code*);
 - 2) debts arising from the obligations of a *depository* (*Art. 1287, Civil Code*);
 - 3) debts arising from the obligations of a *bailee in commodatum* (like the borrower of a bicycle) (*Art. 1287, Civil Code*);
 - 4) debts arising from a claim for future support due by gratuitous title (*Art. 1287, Civil Code*);
 - 5) debts consisting in *civil liability* arising from a penal offense (*Art. 1288, Civil Code*);
 - 6) damages suffered by a partnership thru the *fault* of a partner *cannot* be compensated with *profits* and benefits which he may have *earned for the partnership* by his industry. (*Art. 1794, Civil Code*). *Reasons*: Since the partner has the duty to obtain benefits for the firm, and a duty not to be at fault, there can be *no* compensation because both are *duties*, and the part-

ner is the debtor in *both* instances. (See 11 *Manresa* 377).

[NOTE: The courts may, however, equitably lessen this responsibility of the partner, if, thru the partner's *extraordinary* efforts in other activities of the partnership, unusual profits have been realized. (Art. 1794, *Civil Code*).]

(4) The First Affirmative Requisite

“That each of the obligors be bound *principally*, and that he be at the same time a *principal creditor of the other*.”

- (a) *Firstly*, there must be a *relationship* of debtor and creditor.
- (b) *Secondly*, there must be *two* debts and *two* credits.
- (c) *Thirdly*, they must *generally* be bound as *principals* (and not in their representative capacity).

Example:

G, as guardian for *W*, is a creditor of *D*. *D* in turn is a creditor of *G* who owes him a *personal* debt. There can be NO compensation because it is *W* who is the real creditor, not *G*.

Another example:

A, debtor of *two partners*, cannot compensate the debt with what the *partnership* itself owes her. (*Escano v. Heirs of Escano*, 28 *Phil.* 73).

Another example:

A debtor owes a creditor P1 million but the creditor owes the *debtor's guarantor* P1 million. The debtor *cannot* claim compensation. (HOWEVER, a *guarantor* may set up compensation as regards what the *creditor may owe the principal debtor*. The reason is simple: If the principal obligation is extinguished, the accessory obligation of guaranty is also extinguished.) (See Art. 1280, *Civil Code*).

(5) The Second Affirmative Requisite

“That both debts consist in a *sum of money*, or if the things due are *consumable (fungible)*, they be of the same kind, and also of the same quality if the latter has been stated.”

- (a) The word “consumable” must be taken to mean “fungible” (susceptible of substitution, if such be the intention).
- (b) *Example:*

A owes B a fountain pen (generic). B owes A also a fountain pen (generic). There can be compensation here because the objects are *fungible* (although not consumable).

[NOTE: Had specific fountain pens been agreed upon, there can be *no* compensation (legal compensation).]

[NOTE: Ten sacks of corn cannot be compensation (legal compensation) for ten sacks of rice.]

(6) The Third Affirmative Requisite

“That the two debts be *due*.”

- (a) “Due” means that the *period has arrived*, or the *condition has been fulfilled*. On the other hand, “*demandable*” may refer to the fact that neither of the debts has prescribed, or that the obligation is not invalid or illegal.
- (b) Solita owes Edmundo P1 million payable Apr. 1, 2005. Edmundo owes Solita P1 million payable Jun. 8, 2005. Can there be legal compensation on Apr. 1, 2005?

ANS.: No, for one of the debts is *not* yet due. However, there can be voluntary compensation upon agreement. (See Art. 1282, *Civil Code*).

(7) The Fourth Affirmative Requisite

“That they be *liquidated* and *demandable*.”

- (a) For the meaning of “*demandable*,” see comment No. 6(a).
- (b) If one of the debts has already prescribed, there can be no compensation (8 *Manresa* 411) for the simple reason that said debt is no longer *demandable*.

- (c) “Liquidated” debts are those where the exact amount has already been determined, though not necessarily in figures since capacity of being arrived at by simple arithmetical processes would be enough. If damages are asked for, and the amount is disputed, the debt cannot be said to be already a “liquidated” one. (*Compania General de Tabacos v. French and Unson*, 39 Phil. 34). Once liquidated by a judgment, however, a set-off asked for in a counterclaim would be proper. (8 *Manresa* 409-410).

**Compania General de Tabacos v.
French and Unson
39 Phil. 34**

FACTS: A private common carrier transported gasoline for the government (Bureau of Supply) for P322.93. The Auditor General, however, wanted to deduct from said amount the damages the carrier had caused to the cargo of gasoline, but said damages were still undetermined and unliquidated. *Issue:* Is a set-off proper?

HELD: There can be NO set-off or compensation for the alleged damage caused was still *unliquidated*, and could *not* yet therefore be set-off against the government liability. “Unliquidated damages” cannot be said to be “debts” owing the government.

**Salinap v. Judge del Rosario
GR 50638, Jul. 25, 1983**

Compensation takes place only if both obligations are liquidated. Therefore, it cannot take place if one’s claim against the other is still the subject of court litigation.

**Perez v. Court of Appeals
L-56101, Feb. 20, 1984**

If the loan instruments intended to be set off against each other are not yet due and demandable, there cannot be compensation.

(8) The First Negative Requisite

“That over *neither* of the debts must there be any *retention* or *controversy* commenced by *third* persons and *communicated in due time* to the debtor.”

Example:

A owes B P100,000, and B owes A P100,000, but A's credit of P100,000 has been *garnished* by C who claims to be an unpaid creditor of A. B has been duly notified of the controversy. There can be NO compensation here. (*See Rule 57, Sec. 8, Revised Rules of Court on Garnishment*). Any possible compensation is in the meantime suspended. If C wins his claim, there can be no compensation; if he loses, the controversy is resolved, and compensation can take place. (*8 Manresa 407*).

Art. 1280. Notwithstanding the provisions of the preceding article, the guarantor may set up compensation as regards what the creditor may owe the principal debtor.

COMMENT:**(1) Guarantor May Set Up Compensation With Respect to Principal Debt**

- (a) This is an *exception* to Art. 1279, par. 1, because a guarantor is SUBSIDIARILY, not principally, bound.
- (b) *Reason for the law:* Extinguishment (partial or total) of principal obligation extinguishes (partially or totally) the guaranty (which is merely an accessory obligation).

(2) Examples

- (a) A owes B P500,000. C is the guarantor of A. B owes A P100,000. When B sues A and A cannot pay, for how much will C be liable?

ANS.: C will be liable for only P400,000, because he can set up the P100,000 credit of A as the basis for partial compensation.

- (b) A owes B P500,000. C is the guarantor of A. B owes C P500,000. When B sues A for the P500,000, may A success-

fully put up the defense of compensation in that, after all, his creditor (*B*) owes *C* the same amount?

ANS.: There can be no compensation here because in the obligation which *C* guaranteed for *A*, he (*C*) is not bound in his own right. Neither is *A* the creditor of *B*.

(NOTE: If *A* cannot pay and *B* sues the guaranty, *C* will not be liable anymore because the obligation of guaranty has been extinguished by compensation.)

Art. 1281. Compensation may be total or partial. When the two debts are of the same amount, there is a total compensation.

COMMENT:

Total or Partial Compensation

The Article is true for all the different kinds of compensation, whether voluntary, legal, *etc.*

Art. 1282. The parties may agree upon the compensation of debts which are not yet due.

COMMENT:

Conventional or Voluntary Compensation

- (a) This applies to conventional or voluntary compensation.
- (b) As a matter of fact, the requisites mentioned in Art. 1279 do *not* apply.
- (c) It is sufficient in conventional compensation that the agreement or contract which *declares* the compensation should itself be valid; thus among other things, the parties must have *legal capacity* and must *freely give their consent*.

Art. 1283. If one of the parties to a suit over an obligation has a claim for damages against the other, the former may set it off by proving his right to said damages and the amount thereof.

COMMENT:**(1) Judicial Compensation or Set-off**

- (a) This refers to judicial compensation or set-off. *Pleading and proof* of the counterclaim must be made.
- (b) All the requisites mentioned in Art. 1279 must be present, except that at the time of pleading, the claim need *not* yet be liquidated. The liquidation (or fixing of the proper sum) must be made in the proceedings.
- (c) Unless pleading and proof are made, the court *cannot* of its own accord declare the compensation. This is because of “the supplicatory character of our civil procedure.” (*Reyes & Puno, Outline of Civil Law, Vol. IV, p. 156, citing Castan, De Buen*). The compensation takes place by the judgment, as to the date the compensation was pleaded. (*Reyes & Puno, id.*).

(2) Jurisdiction of the Court Regarding the Value of the Demand

General Rule: The jurisdiction of the court depends upon the *totality of the demand* in all the causes of action, *irrespective* of whether the plural cases arose out of the *same or different transactions*. (*Soriano v. Omilia, 51 O.G. No. 7, p. 3465 and Campos Rueda Corporation v. Sta. Cruz Timber Co., 52 O.G. No. 3, p. 1387*).

Exceptions:

- (a) Where the claim joined under the same complaint are separately owed by, or due to, different parties, in which case each separate claim furnishes the jurisdictional test. (*Argonza, et al. v. International Colleges, L-3884, Nov. 29, 1951 and Soriano y Cia v. San Jose, 47 O.G. 12th Supp., p. 156*).
- (b) Where *not all* the causes of action joined are demands or claims for money. (*Felix Vda. de Rosario v. Justice of the Peace of Camiling, et al., L-9284, Jul. 31, 1956, 52 O.G. No. 5152*).

[NOTE: Consequential damages and attorney’s fees, when properly claimed and recoverable as an item of

damage, are *not excluded* from the jurisdictional amount. (*Suanes v. Almeda-Lopez*, 73 Phil. 573).]

Art. 1284. When one or both debts are rescissible or voidable, they may be compensated against each other before they are judicially rescinded or avoided.

COMMENT:

(1) Compensation in the Case of Rescissible or Voidable Debts

Rescissible or voidable debts are valid *until* rescinded or voided; hence, compensation is allowed.

(2) Prevention of Unfairness

To avoid unfairness if rescission or annulment is *later* on decreed by the court, it is as if NO compensation ever took place. The decree thus acts retroactively.

Example:

A owes B P1 million. Later, A forced B to sign a promissory note for P1 million in A's favor. The first debt is valid; the second is voidable. But if all the requisites for legal compensation are present, both debts are extinguished since B's debt is *not yet annulled*. This is obviously unfair if, later on, B's debt is annulled by the court. Thus here, the compensation that has taken place will be *cancelled*.

Art. 1285. The debtor who has consented to the assignment of rights made by a creditor in favor of a third person, cannot set up against the assignee the compensation which would pertain to him against the assignor, unless the assignor was notified by the debtor at the time he gave his consent, that he reserved his right to the compensation.

If the creditor communicated the cession to him but the debtor did not consent thereto, the latter may set up the compensation of debts previous to the cession, but not of subsequent ones.

If the assignment is made without the knowledge of the debtor, he may set up the compensation of all credits prior to the same and also later ones until he had knowledge of the assignment.

COMMENT:

(1) Effect of Assignment on Compensation of Debts

Under Art. 1290, “when all the requisites mentioned in Art. 1279 are present, compensation takes effect by *operation of law*, and *extinguishes* both debts to the concurrent amount, even though the creditors and debtors are *not aware* of the compensation.” Thus, compensation takes place automatically or *ipso jure*. Now then, if AFTER compensation has taken place one of the extinguished debts is ASSIGNED to a stranger, ordinarily this would be a useless act since there is *nothing more* to assign. The defense of compensation could then be set up.

There is ONE exception to said rule, and this takes place when the assignment (after compensation has already taken place) was made WITH THE CONSENT of the debtor. Such consent operates as a WAIVER of the rights to compensation.

The *exception to the exception* occurs when “at the time he gave his consent, he RESERVED his right to the compensation.” (See 8 Manresa, pp. 413-414).

(2) The Three Cases Covered by the Article

- (a) The assignment may be made with the *consent* of the debtor. (Par. 1, Art. 1285).
- (b) The assignment may be made with the knowledge but without the consent (or against the will) of the debtor. (Par. 2, Art. 1285).
- (c) The assignment may be made *without* the knowledge of the debtor. (Par. 3, Art. 1285).

(3) The First Case — The Assignment may be Made With the Consent of the Debtor [See also Comment No. (1) under this Article]

Effect: Compensation cannot be set up (because there has been *consent* and, *therefore*, a waiver).

Exception: If the right to the compensation (that has already taken place) is reserved.

Example:

A owes B P1,000,000. B in turn owes A P200,000. Because both debts are already due, and because all other requisites for legal compensation are present, both debts are extinguished automatically up to the amount of P200,000. Later however, B, with the consent of A, assigned his (B's) P1,000,000 credit to C. How much can C collect successfully from A?

ANS.: C can collect from A the whole P1,000,000. A cannot set up the defense of compensation as of the P200,000 in view of his consent to the assignment.

(NOTE: Had A reserved his right to the compensation, A would be forced to give only P800,000.)

[NOTE: Par. 1 of Art. 1285 applies whether the consent to the *cession* was BEFORE or AFTER the debts became compensable. (8 Manresa 413-414).]

(4) The Second Case — Assignment Made With the Knowledge but Without the Consent or Against the Will of the Debtor.

Effect: Compensation can be set up regarding debts *previous* to the *cession* or assignment. This refers to debts *maturing before the assignment* (that is, before the NOTICE); hence here, legal compensation has already taken place.

Examples:

- (a) A owes B P1,000,000. B owes A P200,000. Both debts are already due. Later B, with the knowledge but *without* the consent (or against the will) of A, assigned the P1,000,000 credit to C. How much can C successfully collect from A?

ANS.: If A sets up the defense of partial compensation as to *previously maturing* debts, C can collect only P800,000. There had already been compensation with respect to the P200,000.

- (b) A owes B P1,000,000 due on Apr. 2; B owes A P200,000 due also on Apr. 2. On Feb. 4 (when there was no legal compensation yet), B assigned his P1,000,000 credit to C, with the knowledge but without the consent of A. On Apr. 2, how much can C successfully collect from A?

ANS.: P1,000,000, because if at all there would be compensation here, it took place *after* the assignment, not before. It does not matter that the P200,000 had been incurred prior to the *cession*, for when the law speaks of “debts previous to the *cession*,” it refers to debts *maturing before* the *cession* (not to debts incurred prior to such *cession* which have not yet matured before said *cession*).

(5) The Third Case — Assignment Made Without the Knowledge of the Debtor

Effect: Debtor can set up compensation as a defense for all debts *maturing PRIOR* to his *knowledge* of the assignment (whether the debts matured *before* or *after the assignment*).

(NOTE: The crucial time here is the *time of knowledge* of the assignment, *not* the time of assignment itself.)

Example:

A owes B P1,000,000. B owes A in turn P200,000. Both debts are already due. Later, B assigns the P1,000,000 credit to C, without the knowledge of A. This assignment was made on July 1. On Jul. 15, a P250,000 debt of B in favor of A matured. A *learned* of the assignment on Aug. 1. On Aug. 23, a P150,000 debt of B in favor of A matured. Later C asks A to pay his debt. How much can C successfully collect from A?

ANS.: C can collect P550,000 because A can set up the defense of partial compensation regarding the P200,000 and the P250,000 debts, debts which had matured and were therefore already compensable *PRIOR* to his knowledge of the assignment. But A cannot set up the last debt of P150,000 for partial compensation because this matured only *after* he *knew* of the assignment.

(6) Reason for the Article

Art. 1285 has for its purpose the *prevention of fraudulent deprivation of the benefits of total and partial compensation*. (8 *Manresa* 413-414).

Art. 1286. Compensation takes place by operation of law, even though the debts may be payable at different places, but there shall be an indemnity for expenses of exchange or transportation to the place of payment.

COMMENT:**(1) Compensation by Operation of Law**

- (a) This applies to *compensation by operation of law*.
- (b) “Indemnity for *expenses of transportation*” (this applies to transportation of the goods or of the object).
- (c) “Indemnity for *expenses of exchange*” (this refers to monetary exchange, in case the debts are *money debts*).

(2) Example

A owes B P1M payable in Manila and B owes A P1M payable in England. Whoever claims compensation must pay for the exchange rate of currency.

(3) ‘Foreign Exchange’ Defined

Foreign exchange has been defined as the conversion of an amount of money or currency of one country into an equivalent amount of money or currency of another. (See *Dr. Edgardo C. Paras, Economics for Lawyers, 1993, pp. 594-603*).

Art. 1287. Compensation shall not be proper when one of the debts arises from a *depositum* or from the obligations of a depository or of a bailee in *commodatum*.

Neither can compensation be set up against a creditor who has claim for support due by gratuitous title, without prejudice to the provisions of paragraph 2 of Article 301.

COMMENT:**(1) When Legal Compensation Cannot Take Place**

This Article speaks of the instances when *legal compensation* cannot take place, such as:

- (a) When one debt arises from a *depositum* (not bank deposit, for this is really a loan). (*Gullas v. Phil. Nat. Bank*, 62 Phil. 519 and Art. 1980, Civil Code).

(NOTE: The purpose is to prevent breach of trust and confidence.)

(NOTE: It is the depositary who cannot claim compensation. The *depositor* is allowed to so claim.)

- (b) When one debt arises from the obligations of a *depositary*.

(NOTE: This has the same reason as the preceding one. Again, the *depositor* is given the right to claim compensation.)

- (c) When one debt arises from the obligations of a *bailee* in *commodatum* (the *borrower* of property who pays *nothing* for the loan).

(NOTE: Again, the reason here is to prevent a breach of trust.)

(NOTE: The lender may claim compensation; the *borrower* is NOT allowed to do so.)

[NOTE: In the three instances given above, since the depositor and the lender have an *option to claim or not to claim* compensation, we have clear instances of facultative compensation. (See Comment No. 6 {b-4} under Art. 1278).]

- (d) When one debt arises because of a claim for *support* due to *gratuitous title*.

[NOTE: Support in arrears may be compensated (Art. 301, par. 2, Civil Code) but not future support, for this is “vital to the life of the recipient.” (Report of the Code Commission).]

[NOTE: In the foregoing discussion, please observe that while compensation cannot be made use of by one party

(*e.g.*, the *depository*), compensation may be claimed by the other party (*e.g.*, the *depository*). This kind of compensation, whereby only one side can claim it but not the other, is referred to as FACULTATIVE COMPENSATION.]

(2) Some Problems

- (a) A has a P1,000,000 savings deposit with the Phil. National Bank. One day A borrowed P200,000 from the Bank. Without asking permission from A, the Bank subtracted the P200,000 from A's account, leaving a balance of P800,000 in A's favor. Is the bank's action proper?

ANS.: Yes. Compensation is allowed here because in this case, the relationship between the bank and the depositor is that of debtor and creditor. (*See Art. 1980, Civil Code and Gullas v. Phil. Nat. Bank, 62 Phil. 519*).

- (b) A asked B to keep P1,000,000 for him. Now, A is indebted to B for the amount of P400,000. When A asks for the return of his money, B gives him only P600,000, alleging partial compensation. Is B correct?

ANS.: No, B is not correct because the P1,000,000 deposit with him is not subject to compensation. (*Art. 1287, 1st par., Civil Code*).

(3) Obligations of a Depository

The law says that compensation is not proper when one of the debts arises from the *obligations* of a *depository*. Now, what are some of these obligations of a depository?

ANS.:

- (a) The depository is obliged to keep the thing safely and to return it, when required, to the depositor, or to his heirs and successors, or to the person who may have been designated in the contract. (*Art. 1972, Civil Code*).
- (b) Unless there is a stipulation to the contrary, the depository cannot deposit the thing with a third person. (*Art. 1973, id.*).

- (c) If deposit with a third person is allowed, the depositary is liable for the loss if he deposited the thing with a person who is manifestly careless or unfit. (*Ibid.*).
- (d) The depositary is responsible for the negligence of his employees. (*Ibid.*).
- (e) The depositary cannot make use of the thing deposited without the express permission of the depositor. Otherwise, he shall be liable for damages. However, when the preservation of the thing requires its use, it must be used but only for that purpose. (*Art. 1977, id.*).

Art. 1288. Neither shall there be compensation if one of the debts consists in civil liability arising from a penal offense.

COMMENT:

(1) Non-Compensation if One Debt Arises from a Crime

Reason for the provision:

“If one of the debts consist in civil liability arising from a penal offense, compensation would be improper and inadvisable because the satisfaction of such obligation is imperative.” (*Report of the Code Commission, p. 134*).

(2) But Victim Can Claim Compensation

It is clear that the criminal cannot claim compensation. How about the *victim*?

ANS.: He should be allowed. *Justice J.B.L. Reyes* says: “This should be specifically limited to the accused to prevent his escaping liability by pleading prior credits against the offended party. But *not* to the victim of a crime who happens to be indebted to the accused.” (*Observation on the new Civil Code, Justice J.B.L. Reyes, Lawyer’s Journal, Jan. 31, 1951*).

(This is again another instance of FACULTATIVE COMPENSATION.)

Art. 1289. If a person should have against him several debts which are susceptible of compensation, the rules on the application of payments shall apply to the order of the compensation.

COMMENT:

Note the cross-reference to application of payments.

**Steve Tan & Marciano Tan v.
Fabian Mendez, Jr.
GR 138669, Jun. 6, 2002**

FACTS: Petitioner Steve Tan and Marciano Tan are the owners of Master Tours and Travel Corp. and operators of Philippine Lawin Bus Co., Inc. (PLBCI), while respondent Fabian Mendez, Jr. is the owner of three gasoline stations in Iriga City, Ligao in Albay and Sipocot, Camarines Sur. Petitioners opened a credit line for their buses' lubricants and fuel consumption with respondent. At the same time, the latter was also designated by petitioners as the booking and ticketing agent of PLBCI in Iriga City.

Under such an arrangement, petitioners' drivers purchased on credit fuel and various oil products for its buses thru withdrawal slips issued by petitioners, with periodic payments to respondent thru the issuance of checks. Upon the other hand, respondent remitted the proceeds of ticket sales to petitioners also thru the issuance of checks. Sent together with respondent's remittance are the remittances of the ticket sales in the Baao Booking Office, which is managed separately and independently by another agent, Elias Bocsain.

Accordingly, petitioners issued several checks to respondent as payment for oil and fuel products. One of these is FEBTC check 704227 dated Jun. 4, 1991 in the amount of P58,237.75 as payment for gasoline and oil products processed during the period May 2-15, 1991. Said check was dishonored by the bank upon presentment for payment for being drawn against insufficient funds. Respondent sent a demand letter dated Jun. 21, 1991 to petitioners demanding that they make good the check or pay the amount thereof, to no avail. Hence, an information

for violation of BP 22 was filed against petitioners, upon the complaint of respondent before the RTC of Iriga City, Br. 37.

Petitioners pleaded not guilty during arraignment and trial ensued. Upon the other hand, the defense presented petitioner Marciano Tan and Isidro Tan as witnesses. In his testimony, Marciano averred that he cannot be held liable for violation of BP 22 because the amount subject of the check had already been extinguished by offset or compensation against the collection from ticket sales from the booking offices. He presented a memorandum dated Jun. 10, 1991 showing the return to respondent of various uncashed checks in the total amount of P66,839.25 representing remittance of ticket sales in the Iriga and Baao offices that were earlier sent by respondent. After the alleged offset, there remains a balance of P226,785.83.

Upon cross-examination, Marciano admitted to have drawn the subject check to pay private respondent's gasoline station and that it was not covered by sufficient funds at the time of its issuance due to uncollected receivables. Upon query by the court, he claimed that he did not talk to private complainant and could not tell if the latter agreed to offset the checks with the remittances. Isidro Tan, petitioner's brother, corroborated Marciano's claim of offset. He also admitted speaking with Mulry Mendez regarding the proposed settlement of the case which, however, was not accepted by respondent.

On rebuttal, respondent disputed petitioners' claim of payment thru offset or compensation. He claimed that the amount of the four unencashed checks totalling P66,839.25 could not have offset the amount of the dishonored checks since petitioners' total obligations at that time had already reached P906,000. Moreover, even if compensation took place, it should have been applied on an alleged earlier obligation of P235,387.33. Respondent also claimed that compensation did not take place as there was no application of payment made by the petitioners in their memorandum dated Jun. 10, 1991.

After trial, the trial court convicted petitioners for violation of BP 22. On appeal, the Court of Appeals (CA) affirmed the conviction of petitioners, hence, this petition.

ISSUE: Whether the CA erred when it failed to consider the fact of payment by offsetting prior to the demand letter sent

by respondent despite the abundance of evidence proving the same.

HELD: It bears stressing that the issue of whether or not the obligation covered by the subject check had been paid by compensation or offset is a factual issue that requires evaluation and assessment of certain facts. This is not proper in a petition for review on *certiorari* to the Supreme Court. This Court is not a trier of facts (*Luis Wong v. CA & People of the Phils.*, GR 117857, Feb. 2, 2001 and *Aleria, Jr. v. Velez*, 298 SCRA 611 [1998]), its jurisdiction over cases elevated from the CA being confined to the review of errors of law ascribed to the latter, whose findings of fact are conclusive absent any showing that such findings are entirely devoid of any substantiation on record. On this aspect, the CA affirmed the findings of the trial court that the alleged compensation is not supported by clear and positive evidence. For as found by the trial court, petitioners' defense of compensation is unavailing because petitioners did not clearly specify in the memorandum dated Jun. 10, 1991 which dishonored check is being offset. Applying Art. 1289 read together with Art. 1254 of the Civil Code, the unencashed checks amounting to P66,839.25 should have been applied to the earlier dishonored check amounting to P235,387.33 which is more onerous than the subject check amounting to only P58,237.75.

Moreover, no compensation can take place between petitioners and respondent as the latter is not a debtor of the former insofar as the two checks representing collections from the Baao ticket sales are concerned. The Civil Code requires, as a prerequisite for compensation, that the parties be mutually and principally bound as creditors and debtors. (*Art. 1278*). If they were not mutually creditors and debtors of each other, the law on compensation would not apply. (*Ibid.*). In the case at bar, the memorandum shows that some unencashed checks returned to respondent to allegedly offset the dishonored check were from the Baao ticket sales which are separate from the ticket sales of respondent. The latter only acted as an intermediary in remitting the Baao ticket sales and, thus, is not a debtor of petitioners.

Interestingly, petitioners never alleged compensation when they received the demand letter, during the preliminary inves-

tigation, or before trial by filing a motion to dismiss. If indeed there was payment by compensation, petitioners should have redeemed or taken the checks back in the ordinary course of business. (*Alberto Lim v. People of the Phils.*, GR 143231, Oct. 26, 2001, citing *Dico v. CA*, 305 SCRA 637 [1999], and Sec. 3[q], Rule 131, Revised Rules of Court). There is no evidence on record that they did so.

While the Supreme Court sustained the conviction of petitioners, it deemed it appropriate to modify the penalties imposed. It deleted the penalty of imprisonment and *in lieu* thereof, imposed upon petitioners a fine amounting to double the value of the subject check, with subsidiary imprisonment in case of insolvency or non-payment.

In this instant case, the Court notes that petitioners had exerted efforts to settle their obligations. The fact of returning the unencashed checks to respondent indicates good faith on the part of petitioners. Absent any showing that petitioners acted in bad faith, the deletion of the penalty of imprisonment in this case is proper.

The petition is denied and the CA decision is affirmed with modification. Petitioners are ordered to indemnify respondent in the amount of P58,237.75 with legal interest from the date of judicial demand. The sentence of imprisonment of 6 months is set aside and *in lieu* thereof, a fine in the amount of P116,475.50 (P58,237.75 x 2) is imposed upon petitioners, with subsidiary imprisonment not to exceed 6 months in case of insolvency or non-payment. (*Rosa Lim v. People of the Phils.*, 340 SCRA 497 [2000], citing Art. 39, par. 2., Rev. Penal Code; *Diongzon v. CA*, 321 SCRA 477 [1999]; and *Llamado v. CA*, 270 SCRA 423 [1997]).

[NOTE: Supreme Court Administrative Circular 12-2000, as clarified by Administrative Circular 13-2002, established a rule of preference in imposing penalties in BP 22 cases. Sec. 1 of BP 22 imposes the following alternative penalties for its violation, to wit: (a) imprisonment of not less than 30 days but not more than 1 year; or (b) a fine of not less than but not more than double the amount of the check which fine shall in no case exceed P200,000; or (c) both such fine and imprisonment at the discretion of the court. The rationale of Adm. Circular 12-2000

is found in the Supreme Court rulings in *Eduardo Vaca v. CA* (298 SCRA 656 [1998]) and *Rosa Lim v. People of the Phils.* (340 SCRA 497 [2000]). The Court held in those cases that it would best serve the ends of criminal justice if, in fixing the penalty to be imposed for violation of BP 22, the same philosophy underlying the Indeterminate Sentence Law is observed, *i.e.*, that of redeeming valuable human material and preventing unnecessary deprivation of personal liberty and economic usefulness with due regard to the protection of the social order].

[NOTE: To be sure, it is not its intention, opined the Supreme Court, to decriminalize violation of BP 22. Neither is it the intention to delete the alternative penalty of imprisonment. The propriety and wisdom of decriminalizing violation of BP 22 is best left to the legislature and not this Court. As clarified by SC Adm. Cir. 13-2001, the clear tenor of Adm. Cir. 12-2000 is not to remove imprisonment as an alternative penalty, but to lay down a rule of preference in the application of the penalties provided for in BP 22. Where the circumstances of the case, for instance, clearly indicate good faith or a clear mistake of fact without taint of negligence, the imposition of a fine alone may be considered as the more appropriate penalty. This rule of preference does not foreclose the possibility of imprisonment for violators of BP 22. Neither does it defeat the legislative intent behind the law. Needless to say the determination of whether the circumstances warrant the imposition of a fine alone rests solely upon the judge. Should the judge decide that imprisonment is the more appropriate penalty, Adm. Circular 12-2000 ought not to be deemed a hindrance. (*Adm. Cir. 13-2001, cited in Alberto Lim v. People of the Phils., supra*).]

[NOTE further: The Supreme Court is not unaware of the importance of checks in commercial transactions. In commercial parlance, they have been widely and fittingly known as the substitute of money and have effectively facilitated the smooth flow of commercial transactions. The pernicious effects and repercussions of circulating worthless checks are simply unimaginable. It is for this reason that BP 22 was enacted by the legislature, to penalize individuals who would place worthless checks in circulation and degrade the value and importance of checks in commercial transactions. Nevertheless, while this Court recognizes the noble objective of BP 22 it deems it proper

to apply the philosophy underlying the Indeterminate Sentence Law in imposing penalties for its violation. The gist of Adm. Cir. 13-2000 is to consider the underlying circumstances of the case such that if the situation calls for the imposition of the alternative penalty of fine rather than imprisonment, the courts should not hesitate to do so. (*Steve Tan & Marciano Tan v. Fabian Mendez, Jr., supra*).]

Art. 1290. When all the requisites mentioned in Article 1279 are present, compensation takes effect by operation of law, and extinguishes both debts to the concurrent amount, even though the creditors and debtors are not aware of the compensation.

COMMENT:

Automatic Compensation if All Requisites Are Present

- (a) Note that legal compensation takes place automatically *unless* there has been valid waiver thereof.
- (b) Compensation which extinguishes principal obligations also extinguishes accessory obligations. (*Manresa*).
- (c) “To the concurrent amount” means that if one debt is larger than the other, the balance subsists as debt.

**International Corporate Bank, Inc. v. IAC, et al.
GR 69560, Jun. 30, 1988**

FACTS: In 1980, Natividad secured from International Corporate Bank’s (ICB’s) predecessor-in-interest a loan of P50 million. To secure this loan, Natividad mortgaged her real properties in Manila and Bulacan. Of this loan, only P20 million was approved for release. The same amount was applied to pay other obligations to ICB. Thus, Natividad claims that she did not receive anything from the approved loan. Later, Natividad made a money market placement with ICB’s predecessor in the amount of P1 million at 17% interest *per annum* for a period of 32 days. Meanwhile, Natividad allegedly failed to pay her mortgage indebtedness to ICB so that the latter refused to pay the proceeds of the money market placement on maturity but ap-

plied the amount instead to the deficiency in the proceeds of the auction sale of the mortgaged properties. With ICB's predecessor being the only bidder, said properties were sold in its favor for only P20 million. ICB claims that after deducting this amount Natividad is still indebted in the amount of P6 million.

In 1982, Natividad sued ICB for annulment of the sheriff's sale of the mortgaged properties, for the release to her of the balance of her loan from ICB in the amount of P30 million and for recovery of P1 million representing the proceeds of her money market investment. She alleges that the mortgage is not yet due and demandable and, hence, the foreclosure was illegal. ICB answered, saying that it has the right to apply or set off Natividad's money market claim of P1 million. ICB thus interposes counterclaims to recover P5.7 million representing the balance of its deficiency claim after deducting the proceeds of the money market placement.

The trial judge ordered ICB to deliver to Natividad the amount of P1.06 million conditioned upon Natividad's filing a bond. ICB filed a special civil action for *certiorari* with the Court of Appeals. Said court dismissed the petition, saying that the circumstances of this case prevent legal compensation from taking place because the question of whether Natividad is indebted to ICB in the amount of P6.81 million representing the deficiency balance after the foreclosure of mortgage is disputed.

ISSUE: Can there be legal compensation in the case at bar?

HELD: No. Undoubtedly, ICB is indebted to Natividad in the amount of P1.06 million, representing the proceeds of her money market investment. But whether Natividad is indebted to ICB in the amount of P6.8 million representing the deficiency balance after the foreclosure of the mortgage executed to secure the loan is disputed. This circumstance prevents legal compensation from taking place. The validity of the extrajudicial foreclosure sale and ICB's claim for deficiency are still in question, so much so that the requirement of Art. 1279 that the debts must be liquidated and demandable has not yet been met. Hence, legal compensation cannot take place under Art. 1290 of the Civil Code.

Section 6

NOVATION

Art. 1291. Obligations may be modified by:

- (1) Changing their object or principal conditions;**
- (2) Substituting the person of the debtor;**
- (3) Subrogating a third person in the right of the creditor.**

COMMENT:

(1) ‘Novation’ Defined

“By novation is understood the substitution or change of an obligation by another, which extinguishes or modifies the first, either changing its object or principal condition, or substituting another in place of the debtor, or subrogating a third person in the right of the creditor.” (8 *Manresa* 428).

The term “principal conditions” in Art. 1291 of the New Civil Code should be construed to include a change in the period to comply with the obligation, which change in the period would only be partial novation, since the period merely affects the performance, not the creation of the obligation. (*Ong v. Bogñalbal*, 501 SCRA 490 [2006]).

(2) No Difference in Civil and Common Law Concepts of Novation

“Between the civil and common law, with reference to the extinguishment of one obligation by the creation of another, there seems to be no difference. Under both systems of jurisprudence, in order to extinguish one obligation by the creation of another, the extinguishment must be made to clearly appear.” (*Tiu Suico v. Havana*, 45 *Phil.* 707).

“A *novation*, under the rules of the Civil Law, whence the term has been introduced into the modern nomenclature of our common law jurisprudence, was a mode of extinguishing one obligation by another; the substitution, not of a new paper or note, but of a new obligation, in lieu of an old one, the effect of which was to pay, dissolve, or otherwise discharge it.” (*Words and Phrases*, Vol. 5, p. 4848).

(3) Dual Purpose or Function of Novation

“As could be seen, unlike other modes of extinction of obligations, novation is a juridical act of *dual* function in that at the time it extinguishes an obligation, it *creates* a new one in lieu of the old.” (*Gov’t. of the P.I. v. Bautista*, [CA] 37 O.G. No. 97, p. 1880).

[NOTE: While a *true or proper novation extinguishes* an obligation, a partial, modificatory or imperfect novation merely modifies the old obligation. Thus, Art. 1291 says “Obligations may be MODIFIED by . . .” (*See TS, Feb. 10, 1950*). Moreover, since a new or modified obligation arises, novation “does not operate as an absolute but only as a relative extinction.” (8 *Manresa* 428).]

(4) Kinds of Novation

(a) *According to Its Object or Purpose*

- 1) *Real or Objective* — (changing the object or the *principal* conditions of the obligation). (*Art. 1291, par. 1*).
- 2) *Personal or Subjective* — (Change of Persons)
 - A) *Substituting* the person of the debtor (*Expromission or Delegacion*)
 - B) *Subrogating* a third person in the rights of the creditor (change of creditor may be by *agreement* — “conventional subrogation,” or by *operation of law* — “legal subrogation”)
- 3) *Mixed* (Change of Object and Parties)

(b) *According to the Form of Its Constitution*

- 1) *express*
- 2) *implied* (when the two obligations are essentially incompatible with each other)

(c) *According to Its Extent or Effect*

- 1) *total or extinctive* novation (when the old obligation is completely extinguished)

**Iloilo Traders Finance, Inc. v. Heirs
of Oscar Soriano, Jr., et al.
GR 149683, Jun. 16, 2003**

FACTS: The parties to a case for the collection of a loan increased the indebtedness due to accruing interest, from P290,691 to P431,200. The compromise agreement extended the period of payment and provided for new terms of payment, and provided for a waiver of claims, counterclaims, attorney's fees, or damages that the debtors might have against their creditors. However, the settlement neither cancelled, nor materially altered the usual clauses in the real estate mortgages, *e.g.*, the foreclosure of the mortgaged property in case of default. *Issue:* Could it be said that the original obligation of the debtors had been impliedly modified?

HELD: Yes. Novation is merely modificatory where the change brought about by any subsequent agreement is merely incidental to the main obligation (*e.g.*, a change of interest rates). (*Bank of Philippines Islands v. Abaladejo*, 53 Phil. 14) or an extension of time to pay. (*Kabankalan Sugar Co. v. Pacheco*, 55 Phil. 555).

Novation of a contract may either be extinctive or modificatory, much being dependent on the nature of the change and the intention of the parties.

Extinctive novation is never presumed; there must be an express intention to novate. In cases where it is implied, the acts of the parties must clearly demonstrate their intent to dissolve the old obligation as the moving consideration for the emergence of the new one. Implied novation necessitates that the old obligation is completely superseded by the new one.

The test of incompatibility is whether they can stand together, each one having an independent existence, if they cannot and are irreconcilable, the subsequent obligation would also extinguish the first. An extinctive novation would, thus, have the twin effects of, *first*, extinguishing an existing obligation and,

second, creating a new one in its stead. This kind of novation presupposes a confluence of four (4) essential requisites: (1) a previous valid obligation, (2) an agreement of all parties concerned to a new contract, (3) the extinguishments of the old obligation, and (4) the birth of a valid new obligation.

- 2) *partial* or *modificatory* — (this is also termed imperfect or improper novation)

[Here the old obligation is *merely* modified; thus, it still remains in force except insofar as it has been modified. Should there be any doubt as to whether the novation is total or partial, it shall be presumed to be merely modificatory. (*TS, Dec. 30, 1935*).]

(5) Requisites for Novation (in General)

- (a) The existence of a VALID old obligation.

[NOTE: 1) If the old obligation is VOID or NON-EXISTENT, there is nothing to novate. (*Madamba Vda. de Adiarde v. Tumaneng, 88 Phil. 333*).

- 2) If the old obligation is VOIDABLE, novation is still possible provided the obligation has not yet been annulled. (*Art. 1298, Civil Code*).]

- (b) The *intent* to *extinguish* or to *modify* the old obligation by a *substantial difference* (the extinguishment or modification itself is a RESULT of novation).
- (c) The *capacity* and *consent of all the parties* (except in the case of *expromision*, where the old debtor does *not* participate).

Boysaw, et al. v. Interphil Promotions, et al. GR 22590, Mar. 20, 1987

The consent of the creditor to the change of debtors, whether in *expromision* or *delegacion*, is an indispensable requirement. Substitution of one debtor for another may delay or prevent the fulfillment of the obligation by reason

of the inability or insolvency of the new debtor. Hence, the creditor should agree to accept the substitution in order that it may be binding on him.

Example: In a contract where *X* is the creditor and *Y* is the debtor, if *Y* enters into a contract with *Z* under which he transfers to *Z* all his rights under the first contract, together with the obligations thereunder, but such transfer is not consented to or approved by *X*, there is no novation. *X* can still bring his action against *Y* for the performance of their contract or damages in case of breach.

- (d) The validity of the new obligation. (*Tiu Suico v. Habana*, 45 Phil. 707).

[NOTE: If the new obligation is subject to a suspensive condition, such as the obtaining of some signatures, and the condition does not materialize, such new obligation never became valid or effective, so no novation has resulted. (*Martinez v. Cavives*, 25 Phil. 581). If the contemplated new obligation is embodied in a mere draft, which is unsigned and therefore not consented to, no new obligation is created because of the absence of novation. (*Vaca v. Kosca*, 26 Phil. 388).]

Torres, et al. v. CA
GR 92540, Dec. 11, 1992

Raising for the first time the issue of novation only when the case was already in the Court of Appeals does not deserve consideration in this petition.

(6) Novation Is Not One of the Means Recognized by the Revised Penal Code Whereby Criminal Liability can be Extinguished

SSS v. Dept. of Justice, et al.
GR 158131, Aug. 8, 2007

Novation, a civil law concept relating to the modification of obligations (*See Arts. 1291-1304, Sec. 6, Chap. 4, Title I, Book IV of the new Civil Code*), is not one of the means recognized by the Revised Penal Code whereby criminal liability can be

extinguished; hence, the role of novation may only be to either prevent the rise of criminal liability or to cast doubt on the true nature of the original basic transportation, whether or not it was such that its breach would not give rise to penal responsibility, as when money loaned is made to appear as a deposit, or other similar disguise is resorted to. (*People v. Nery*, L-19567, Feb. 5, 1964). For that matter, novation has been invoked to reverse convictions in cases where an underlying contract initially defined the relation of the parties.

Note that the case of *Cruz v. Gangan* (443 Phil. 856), cited by petitioners in their pleadings, where the victims of robbery were exonerated from liability, find no application to the instant case.

Cruz v. Gangan
443 Phil. 856 (2003)

FACTS: Dr. Filonila O. Cruz Camanaya District Director of TESDA, boarded the LRT from Sen. Puyat Ave. to Monumento when her handbag was slashed and the contents were stolen by an unidentified person. Among those stolen were her wallet and the government-issued cellular phone. She thus reported the incident to the police authorities. However, the thief was not located, and the cellphone was not recovered. She also reported the loss to the Regional Director of TESDA, and she requested that she be freed from accountability for the cellphone. The Resident Auditor of the COA denied her request on the ground that she lacked the diligence required in the custody of government property and was ordered to pay the purchase value in the total amount of P4,238. The COA found no sufficient justification to grant the request for relief from accountability. Issue: Is the COA's findings correct?

HELD: The Supreme Court reversed the ruling and found that riding the LRT cannot *per se* be denounced as a negligent act more so because Cruz's mode of transit was influenced by time and money consideration; that she boarded the LRT to be able to arrive in Caloocan in time for 3 p.m. meeting; that any prudent and rational person under similar circumstances can reasonably be expected to do the same; that possession of a cellphone should not hinder one from boarding the LRT coach

as Cruz did considering that whether she rode a jeep or bus, the risk of theft would have also been present; that because of her relatively low position and pay, she was not expected to have her own vehicle or to ride a taxicab; she did not have a government-assigned vehicle; that placing the cellphone in bag away as she did is ordinarily sufficient care of a cellphone while travelling on board the LRT; and that the records did not show any specific act of negligence on her part and negligence can never be presumed.

Art. 1292. In order that an obligation may be extinguished by another which substitutes the same, it is imperative that it be so declared in unequivocal terms, or that the old and the new obligation be on every point incompatible with each other.

COMMENT:

(1) Express and Implied Novation

According to the manner or form in which the novation has been constituted or made, novation is classified into:

- (a) *express novation*, it is declared in unequivocal terms. (*Art. 1292*).
- (b) *implied novation* (complete or substantial incompatibility). (*Borja v. Mariano, 38 O.G. 2576; see Guerrero v. Court of Appeals, L-21676, Feb. 28, 1969*).

(2) How Implied Novation May Be Made

Implied novation is done by making SUBSTANTIAL CHANGES —

- (a) in the *object* or *subject matter* of the contract (*Example: delivery of a car instead of a diamond ring*)
- (b) in the *cause* or *consideration* of the contract [*Example: an upward change in the price. (Matute v. Hernandez, 6 Phil. 68).*]

(NOTE: Reduction in price implies a *remission*.)

- (c) in the *principal terms* or *conditions* of the contract

[Examples:

- 1) if a debt subject to a condition is made an absolute one without a condition. (*Macondray v. Ruiz*, 66 Phil. 562).
- 2) reduction of the term or period originally stipulated. (*Kabankalan Sugar Co. v. Pacheco*, 55 Phil. 555).
- 3) when, without the consent of some subscribers, the capital stock of a corporation is increased. Here the subscribers who did not consent to the increase are released or freed from their subscription. (*National Exchange Co. v. Ramos*, 51 Phil. 310).]

[NOTE: Novation thru change of the object, cause, or principal terms and conditions is not presumed; clear proof of novation must be given. (Martinez v. Cavives, 25 Phil. 591).]

(3) Cases

National Exchange Co., Ltd. v. Ramos **51 Phil. 310**

FACTS: A corporation was being established. A subscribed to some shares of stock in the proposed corporation. Without A's consent, the authorized capital of the corporation was increased. *Issue:* Is A relieved of his obligation to pay for said shares?

HELD: Yes. "One who subscribes for stock of a proposed corporation is relieved of his obligation, if, without his consent, the authorized capital stock of the corporation is increased."

Rios, et al. v. Jacinto, Palma y Honos **49 Phil. 7**

FACTS: A rented a house from B. In the contract of lease, the lessee A was given authority to assign the lease to strangers. Because of this A leased it to C. *Issue:* Is A released from his obligation towards the lessor B?

HELD: "A provision in a lease under which the lessee is authorized to assign it to strangers to the contract does not, in the event of such assignment, release the original lessee from

his obligations to the lessor, unless it be specifically agreed that the assignment shall have that effect.”

Petterson v. Azada
8 Phil. 432

FACTS: A owed C P500 and P3,000 evidenced by two promissory notes. Later, a new loan of P300 was obtained. By express agreement, the three debts were consolidated into one promissory note for P3,800 (P500 plus P3,000 plus P300). That the last promissory note was to take the place of the others was *agreed upon*. *Issue:* Is there novation here?

HELD: Yes, in view of the changes made.

(*NOTE:* Had there been no proof that the third note intended to replace the others, there really would be nothing inconsistent with having different notes for different amount. If there is no novation, all the obligations would remain subsisting and the debtor would be liable for all.)

Ganzon v. Judge Sancho
GR 56450, Jul. 25, 1983

If a mortgage agreement is replaced by a surety bond, the mortgagee's right would be abridged. A mortgage lien is a right *in rem* and is inseparable from the property, while the lien of a surety is only a right *in personam*.

Teofisto Guingona, Jr. v. City Fiscal of Manila
L-60033, Apr. 4, 1984

If a trust relationship is novated to a debtor-creditor or loan relationship *prior* to the filing of a criminal information by the fiscal, there would be no criminal liability for estafa.

(4) Instances When the Court Held That There Was NO Extinctive Novation

(Here the original contract or obligation remains, subject only to the slight modifications introduced. In other words, only a *modificatory* novation has been effected.)

- (a) When there are only *slight* alterations or modifications in the construction plans of a building. (*Tiu Suico v. Habana*, 45 Phil. 707).
- (b) When the new contract merely contains *supplementary agreement*. (*Asiatic Petroleum Co. v. Quarry Sim Pao*, [CA] 40 O.G. Supp. Nov. 1, 1941, p. 44).
- (c) When *additional interest* is agreed upon. (*Bank of the P.I. v. Gooch*, 45 Phil. 514).
- (d) When additional security is given. (*Bank of the P.I. v. Her-ridge*, 47 Phil. 57).
- (e) When, after a final judgment, a contract was entered into precisely to provide a method of payment other than that stated in the judgment. (*Zapanta v. Rotaeché*, 21 Phil. 154).

[NOTE: But the Supreme Court has held that if the object of the new contract is to settle the judgment, by reducing the amount stated in the judgment, and by stipulating an attorney's fees in case of non-payment, and by inserting a penalty clause, the *judgment* may be considered to have been novated. (*Fua Cam Lu v. Yap Fauco*, 74 Phil. 287).]

- (f) When a guarantor enters into an agreement with the creditor that he (the guarantor) will also be a principal debtor. (Here the original principal debtor is not released from his obligation). (*Santos v. Reyes*, 10 Phil. 123).
- (g) When the creditor in the meantime *refrains* from (or forbears from) suing the debtor (*Teal Motors v. Continental Ins. Co.*, 59 Phil. 814), or even when the creditor *merely* extends the term of payment, for here the period merely affects the performance, *not* the creation of the obligation. (*Inchausti v. Yulo*, 32 Phil. 978 and *Zapanta v. De Rotaeché*, 21 Phil. 154).

[NOTE: However, guarantors who do *not* consent to the extension of term are released from their obligation of guaranty by express provision of the law, and *not* because of any extinctive modification. (See Art. 2079, Civil Code).]

- (h) When the place of payment is changed or when there is a variation in the amount of partial payments. (*8 Manresa 429*).
- (i) When a public instrument is executed to *confirm* a valid contract, whether oral or in a private instrument. (*Ibid.*)
- (j) When payment of the purchase price for certain trucks is made by the execution of a *promissory note* for *said price*. Here, there is *no* novation of the contract of sale. (*Luneta Motor Co. v. Baguio Bus Co., L-15157, Jun. 30, 1960*).

(5) Cases

Tiu Suico v. Habana **45 Phil. 707**

FACTS: A engaged B to construct a building for him (A). In the process of the construction, many written alterations were agreed upon and really made, but it was proved that essentially, the plans followed were the original plans. It must be stated that in the contract, a specific amount for the construction was agreed upon. Later, when the building was finished, the contractor wanted to abandon the original price on the ground that the alterations in the building had caused an abandonment or a *novation* of the old contract. The contractor therefor wanted to be paid, not on the basis of the contract, but on the basis of *quantum meruit*. The owner did not consent to this. **Issue:** Was there novation here?

HELD: There was no novation here. The old contract was not abandoned since, after all, the original plans were followed. Therefore, without the consent of the owner, the contractor cannot treat the old contract as abandoned. The contractor, without the consent of the owner, cannot recover on the basis of *quantum meruit* (on the work done). Rather, the contract price will form the basis for payment, plus the cost of the alterations.

(**NOTE:** Under Art. 1724 of the New Civil Code, the contractor cannot demand an increase in the price unless the change in the plans and specifications was *authorized in writing* and the *additional* price to be paid was also determined in writing by both parties. Under the old Civil Code, *no such requisite in writing was essential.*)

Asiatic Petroleum Co. v. Quay Sim Pao
(C.A.) 40 O.G. Supp. Nov. 1, 1941, p. 44

FACTS: A, in a contract of agency with B, agreed to be the agent of the latter. In the course of the agency, the agent was given certain privileges and facilities, which, however, were not incompatible with the old agreement. *Issue:* Was there novation here?

HELD: There was no novation here because there is real incompatibility between the old and the new agreements. Besides, the new agreement was merely of a supplemental nature.

Zapanta v. Rotaeche
21 Phil. 154

FACTS: In a final judgment, Zapanta was declared the debtor of Ortiz. Later, Zapanta and Ortiz agreed that the judgment was to be extinguished by payment in monthly installments, with the stipulation that in case of default, Ortiz could sue Zapanta. Zapanta later defaulted. Ortiz, to protect his rights, obtained an execution of the final judgment referred to, and so the property of Zapanta was levied upon. Zapanta now instituted this action for damages on the ground that the execution was improper, the judgment having been extinguished by novation.

HELD: The contract did not expressly extinguish the obligations existing in said judgment. On the contrary, it expressly recognizes the obligations existing between the parties in said judgment, and expressly provides a method by which the same shall be extinguished. The contract, instead of containing provisions absolutely incompatible with the obligations of the judgment, expressly ratifies such obligations and contains provisions for satisfying them. The said agreement simply gave Zapanta a method and more time for the satisfaction of the judgment. It did not extinguish the obligations contained in the judgment until the terms of said contract had been fully complied with. Had Zapanta continued to comply with the conditions of the contract, he might have successfully invoked its provisions against the issuance of an execution upon the said judgment. The contract and the punctual compliance with its terms only delayed the right

of the defendant to an execution upon the judgment. There was therefore no novation, and execution was proper.

Fua Cam Lu v. Yap Fauco
74 Phil. 287

FACTS: A debtor was, by *final judgment*, ordered to pay P1,500, with legal interest and costs. Later, the debtor executed a mortgage in favor of the judgment creditor containing the following terms:

- 1) The debt was reduced to P1,200, payable in four monthly installments of P300 each.
- 2) The debtor's *camarin* was mortgaged to the creditor.
- 3) In case of failure to pay any of the installments, the debtor would pay for attorney's fees and judicial costs — in the action to be brought by the creditor.
- 4) The difference of P300 would have to be given to the creditor.
- 5) The agreement was entered into as a settlement of the judgment.

ISSUE: Was there extinctive novation?

HELD: There was extinctive novation, in view of the *incompatibility* between the judgment and the contract, considering the fact that the judgment was payable at once, was unsecured, and contained a stipulation for attorney's fees. The contract was NOT a mere extension of the period within which to pay the judgment because the contract itself stated that the promise to pay the P1,200 was precisely made as a *settlement* of said judgment. There would have been *no settlement* had it not been *implicitly* agreed that the obligation in the judgment was considered by both parties as *already extinguished*.

Inchausti and Co. v. Yulo
34 Phil. 978

FACTS: Four people were solidarily bound in a contract made on Aug. 12, 1909. On May 12, 1911, three of them made a contract with the creditor giving the three debtors different

terms and conditions for the payment of the obligation. Said new contract reaffirmed the liability of the debtor not present. When the absent debtor, Gregorio Yulo, was asked to pay, he presented the defense of novation to the effect that the second contract is incompatible with the first, and that, therefore, he should not be made to pay. *Issue*: Is Gregorio Yulo correct?

HELD: No, Gregorio Yulo is wrong. Far from providing that the obligation of *four* was being substituted by the obligation of three, the new contract ratified or reaffirmed the obligation of the absent debtor, and therefore the absent debtor, Gregorio Yulo, must pay. *Said the Supreme Court*:

“With respect to the third, there can also be no doubt that the contract of May 12, 1911, does not constitute a novation of the former one of Aug. 12, 1909, with respect to the other debtors who execute this contract, or more concretely, with respect to the defendant Gregorio Yulo: *First*, because in order that an obligation may be extinguished by another which substitutes it, it is necessary that it should be so expressly declared or that the old and the new be incompatible in all points,” and the instrument of May 12, 1911, far from expressly declaring that the obligation of the three who executed it *substitutes the former* signed by Gregorio Yulo and the other debtors, expressly and clearly stated that the obligation of Gregorio Yulo to pay the two hundred and fifty-three thousand and odd pesos sued for exists, stipulating that the suit must continue its course, and if necessary, these three parties who executed the contract on May 12, 1911, would cooperate in order that the action against Gregorio Yulo might prosper (7th point in the statement of facts), with other undertakings concerning the execution of the judgment which might be rendered against Gregorio Yulo in this same suit. “It is always necessary to state that it is the intention of the contracting parties to extinguish the former obligation by the new one. (*Judgment in cassation, Jul. 8, 1909*). There exists no incompatibility between the old and the new obligation as will be demonstrated in the resolution of the last point, and for the present we will merely reiterate the legal doctrine that an obligation to pay a sum of money is not novated in a new instrument wherein the old is ratified, by changing only the term of payment and adding other obligations not incompatible with the old one.” (*Judgments in cassation of Jun. 28, 1904 and of Jul. 8, 1909*).

People v. Nery
L-19567, Feb. 5, 1964

FACTS: Soledad Nery was given by Federia Mantillaro two diamond rings to be sold by her. If successful, Nery was supposed to receive a commission. She failed to return the rings or their cash value, so the owner sued her for estafa. While the case was pending, she executed a deed of compromise, promising to pay for the money in installments. After making one payment, she did not continue paying for the balance. She now contends that she ought to be acquitted because the acceptance by the owner of the partial payment NOVATED the original relation between the parties.

HELD: She is still guilty of estafa, *firstly*, because the exaction of criminal responsibility is something that can be renounced only by the State, not by the offended party; and *secondly*, because there was *no intent* to extinguish the original relationship. The novation theory may perhaps apply PRIOR to the filing of the criminal information in court because up to that time, the original trust relation may be converted by the parties into an ordinary creditor-debtor situation, thereby placing the victim *in estoppel* should he insist on the original trust. But AFTER the filing of the case in court, the offended party may no longer divest the prosecution of its power to exact the criminal liability as distinguished from the civil. The crime being an offense against the State, only the latter may renounce the criminal consequences. The acceptance of partial satisfaction cannot indeed effect the nullification of a criminal liability that is already fully mature and in the process of judgment. (*U.S. v. Montanes*, 8 Phil. 620; *Abeto v. People*, 90 Phil. 581 and *Camus v. Court of Appeals*, 48 O.G. No. 3898).

Carlos B. Gonzales v. Eulogio Serrano
L-25791, Sept. 23, 1968

FACTS: By virtue of an agreement which was on the surface one of C.O.D. (Cash on Delivery), but which was really an agency to sell, Carlos B. Gonzales delivered to one Librada S. Asis certain flowers worth approximately P10,000. When the woman took delivery of the flowers, she paid P2,000 cash and issued a check for P8,000. The next day, she requested Gonzales

not to deposit the check for she did not have sufficient funds in the bank as she had not yet been able to dispose of the flowers. Gonzales agreed by not depositing the check. Nearly a month later she made a partial payment of P5,500 on the balance. Regarding the remaining debt, she offered to return the unsold flowers corresponding to the amount of the deficiency. Gonzales then sued her for *estafa*. *Issue*: Is she guilty of *estafa*?

HELD: She is not guilty of *estafa*, in view of the following reasons:

- (a) The agreement, although apparently one of C.O.D., was actually an agency to sell; she could return the unsold goods instead of the price therefor. Here, she is willing to return; and even if she does not, there would only be a *civil* obligation, *not* a criminal offense.
- (b) Even granting that a trust relation had been created because of the C.O.D. and the issuance of the check, still there would be *no liability for a crime* because the parties, a short time after the delivery of the check, changed the original trust relation into an ordinary creditor-debtor situation. Hence, the *novation* of the contract took place *long before* the filing of the criminal complaint.

La Campana Food Products, Inc. v. PCIB, et al.
GR 46405, Jun. 30, 1986

Where the mortgagee-bank agreed to guarantee the mortgagor's foreign loan subject to the condition that the latter should deposit with the former the proceeds of the loan which should be made available for payment to the mortgagor's obligation to a local financial institution and to serve as working capital, the mortgagee-bank did not substitute the mortgagor as debtor to the financial institution.

The mortgagee-bank's guarantee has to be secured by the first mortgage on the assets then mortgaged to the said bank and the assets offered as additional securities, which included the parcels of land mortgaged to the finan-

cial institution. Hence, the mortgagee-bank requires the financial institution to lend the transfer certificates of title covering the parcels of land mortgaged by the mortgagor to the financial institution for the mortgagee-bank to be able to register its mortgage therein.

Bisaya Land Transportation Co., Inc. v. Sanchez
GR 74623, Aug. 31, 1987

FACTS: A, the receiver of BISTRANCO, and S entered into a shipping agency contract whereby S was constituted as shipping agent and was to receive 10% commission on all freight and passenger revenues coming from Butuan City and 5% for all freight going to Butuan. Thereafter, a memorandum of agreement was entered into whereby the rate of commission for freight and passage was reduced from 10% to 7-1/2% and the term of the contract reduced from 5 years to a term of one year renewable yearly upon mutual consent.

Later, BISTRANCO contacted the shippers advising them to transact their business directly with its new branch office. S sued BISTRANCO for specific performance. BISTRANCO answered that the working agreements executed by S and BISTRANCO novated the agency contract.

HELD: The memorandum of agreement was not meant to novate the contract. The intent of the parties was to suspend some of the provisions of the contracts for a period of one (1) year, during which the provisions of the Agreement will prevail. Thus, the agreement that: "It is in this spirit of cooperation with A to enable him to pay huge obligations of the company that agent S has acceded to the request of BISTRANCO to accept the reduction of his commissions."

It would not be equitable for S to say that the contracts were extinguished and substituted by the Agreement. It would punish S for concessions he extended to BISTRANCO.

The changes were not really substantial to bring about novation. The changes between the contract and the agreement did not go into the essence of the cause or object of the agreement. Under the agreement, S remains the

agent of BISTRANCO. There is no clear incompatibility. The contract and the agreement can be reconciled. The provisions of the agreement which were more of changes on how to enforce the agency prevailed during the period provided in them, but after their expiration, the conditions under the contracts were implemented again.

Reyes v. CA
76 SCAD 29
(1996)

The mere circumstance of the creditor receiving payments from a third party who acquiesced to assume the obligation of the debtor when there is clearly no agreement to release the debtor from the responsibility does not constitute novation.

At most, it only creates a juridical relation of co-debtorship or suretyship on the part of the third party to the contractual obligation of the debtor, and the creditor can still enforce the obligation against the debtor.

Art. 1293. Novation which consists in substituting a new debtor in the place of the original one, may be made even without the knowledge or against the will of the latter, but not without the consent of the creditor. Payment by the new debtor gives him the rights mentioned in Articles 1236 and 1237.

COMMENT:

(1) Personal or Subjective Novation

There are two kinds of *personal* or *subjective* novation:

- (a) change of the debtor (passive)
- (b) change of the creditor (active)

De Cortes v. Venturanza
79 SCRA 709

A substitution of debtor without the consent of the creditor is binding upon the parties to the substitution but not on the creditor.

(2) Substitution of Debtor

Art. 1293 speaks of *passive subjective novation* (substitution of the debtor), which may be in the *form of*:

- (a) *expromision* (where the initiative comes from a third person). (*Art. 1294, Civil Code*).
- (b) *delegacion* (where the initiative comes from the debtor, for it is he who *delegates* another to pay the debt, and thus, he excuses himself. Here the three parties concerned — the old debtor, the new debtor, and the creditor — must agree). (*Art. 1295, id.*).

(3) Expromision

- (a) Here the initiative comes from a *third person*.
- (b) It is essential that the old debtor be RELEASED from his obligation, otherwise there will be *no expromision, no novation*.

Example:

D owes *C* P1,000,000. *F*, a friend of *D*, approaches *C* and tells him: “I will pay you what *D* owes you.” *C* agrees. Is there *expromision* here?

ANS.: Under the facts given, there is no *expromision* because they did *not* agree that *D* would be released from his obligation. If *F* therefore does not pay *C*, *C* will still be allowed to collect from *D*. It is evident here that *no novation* exists because it may be that *C* understood *F* to be acting merely as the agent of *D*, although *F* may not have done so as such agent. (*See 8 Manresa 435*). Thus, it has been ruled that if a creditor accepts partial payments from a third person who has decided to assume the obligation, BUT there is no agreement that the first debtor shall be released from responsibility, *no novation* has yet taken place, and the creditor can still enforce the obligation against the original debtor. (*See Magdalena Estates, Inc. v. Rodriguez, L-18411, Dec. 17, 1966*).

Example of True Expromision:

D owes *C* P1,000,000. *F*, friend of *D*, approaches *C* and tells him: “I will pay you what *D* owes you. From now on, consider me your debtor, not *D*. *D* is to be excused. Do you agree?” *C* agrees. Is there *expromision* here?

ANS.: Yes, and even if *F* does *not* pay *C*, *D* cannot be held liable anymore because his obligation has already been extinguished. (*Art. 1294* provides that: “If the substitution is without the knowledge or against the will of the debtor, the new debtor’s *insolvency* or *non-fulfillment* of the obligation shall not give rise to any liability on the part of the original debtor.”)

(4) Requisites for Expromision

- (a) The initiative must come from a third person (who will be the new debtor).
- (b) The new *debtor* and the *creditor* must CONSENT. (*Garcia v. Khu Yek Chiong*, 38 O.G. No. 926).
- (c) The old debtor must be *excused* or *released* from his obligation.

[NOTE: The old debtor’s consent or knowledge is not required. (*Art. 1293, Civil Code*).]

[NOTE: The mere written statement of a widow that she hoped to pay part of her husband’s bank debt does *not* result in *expromision*. (*Garcia v. De Manzano*, 39 Phil. 577).]

Gil Villanueva v. Filomeno Girged
L-15154, Dec. 29, 1960

FACTS: Girged owed Villanueva a certain sum of money. Legaspi wrote Villanueva a letter stating that he (Legaspi) would be “the one to take care” of Girged’s debt “as soon as” Girged has made a shipment of logs to Japan. Girged never made such shipment. Legaspi did NOT pay Villanueva. *Issue:* Is Legaspi liable to Villanueva?

HELD: No. First, because Legaspi did NOT assume Girged’s debt. He merely assured that the debt would be taken

cared of. Secondly, even granting that there was an assumption of indebtedness, still the condition — the shipment — has NOT yet been fulfilled. Thus, Legaspi cannot be held liable.

(5) Delegation

- (a) This is defined as a method of novation caused by the replacement of the old debtor by a new debtor, who (the old debtor) has *proposed* him to the creditor, and which replacement has been agreed to by said creditor and by said new debtor.
- (b) Note that here the *delegacion* or initiative comes from the old debtor *himself*.
- (c) As in the case of *expromision*, the old debtor must be *released* from the obligation; otherwise, there is *no valid delegacion*.

Example:

If a debtor phones his creditor and tells him that *F*, a friend, will pay the debt, and the creditor agrees, this does *not* necessarily mean that a *delegacion* has been effected, for after all, the friend may be acting only as an agent, messenger, or employee of the debtor. Upon the other hand, if the debtor tells the creditor, “My friend *F* will pay my debt. I, therefore, wish to be *released* from my obligation,” and both the friend and the creditor agree, this would be a correct *example* of *delegacion*. In such a case, if *F* fails to pay, will the old debtor be excused?

ANS.: Generally yes, in view of the *novation*, except if *F*’s failure to pay was due to *insolvency*, and such insolvency was already existing and of public knowledge OR *already existing* and *known* to the *debtor* when he delegated his debt. (Art. 1295). The reason for the exception is evident: his obvious bad faith. (See 8 Manresa 437).

C.N. Hodges v. Matias C. Rey **L-12554, Feb. 28, 1961**

FACTS: Rey borrowed from Hodges the sum of P3,000. Three days after the loan was contracted, Rey by means of a letter, authorized the Phil. Nat. Bank to *pay* his in-

debtedness to Hodges out of whatever crop loan might be granted to him by said bank. On the same date, the Bank agreed. But the Bank paid Hodges only P2,000. On the date of maturity, Hodges sued the Bank and Rey for the remaining P1,000. *Issue*: Is the Bank liable to Rey?

HELD: No, for the Bank did NOT assume Rey's indebtedness. The fact that it paid P2,000 does not bind the Bank for the remainder of P1,000, for what it did was to merely make available to the creditor what it could lend to Rey.

(6) The Parties in Delegacion

- (a) The *delegante* — the original debtor
- (b) The *delegatario* — the creditor
- (c) The *delegado* — the new debtor

(7) Requisites for Delegacion

- (a) The initiative comes from the *old debtor*.
- (b) All the parties concerned must consent or agree. (*Garcia v. Khu Yek Chiong*, 65 Phil. 466 and *Adiarde v. Court of Appeals, et al.*, 92 Phil. 758.)

[NOTE: The consent of the creditor:

- 1) may be given in any form (*Rio Grande Oil Co. v. Coleman*, [CA] 39 O.G., p. 986, Mar. 29, 1941);
- 2) may be *express*, or may be *implied from his acts* (*Asia Banking Corporation v. Elser*, 54 Phil. 994 and *Barretto y Cia v. Alba & Sevilla*, 62 Phil. 593) but not from his mere acceptance of payment by a third party, for there is no true transfer of the debt here (*Pac. Com. Co. v. Sotto*, 34 Phil. 237);
- 3) may be *before* or *after* the new debtor has given his consent (*TS, Jun. 16, 1908* and *Estate of Mota v. Serra*, 47 Phil. 464);
- 4) may be conditional, but the condition has to be fulfilled; otherwise, there is no valid *delegacion*. (*Gov't. v. Bautista*, [CA] 7 O.G. [47] 1880).]

(8) Rights of the New Debtor

The law says that “payment by the new debtor gives him the rights mentioned in Arts. 1236 and 1237” (namely, “beneficial reimbursement,” if payment was made *without the knowledge or against the will of the old debtor*; “reimbursement and subrogation,” if it was made with the old debtor’s consent).

(9) Novation Cannot Bind Respondent

Not a Party to the Assignment.

Public Estates Authority v. Elpidio S. Uy
GR 147933-34, Dec. 12, 2001

FACTS: Petitioner argues that its liability to respondent has been extinguished by novation when it assigned and turned over all its contracted works at the Heritage Park to the Heritage Park Management Corp.

HELD: This cannot bind respondent, who was not a party to the assignment. Moreover, it has not been shown that respondent gave his consent to the turnover. (*See Art. 1293, Civil Code*).

Art. 1294. If the substitution is without the knowledge or against the will of the debtor, the new debtor’s insolvency or non-fulfillment of the obligation shall not give rise to any liability on the part of the original debtor.

COMMENT:**(1) Effect of Insolvency or Non-Fulfillment by New Debtor in Expromision**

- (a) This refers to *expromision*.
- (b) Reason why the old debtor will not be responsible for the new debtor’s INSOLVENCY or NON-FULFILLMENT: The *expromision* was brought about without his initiative. (8 *Manresa* 439).

(2) Query

The Article says “if the substitution is *without the knowledge or against the will of the debtor*.” Now, then, suppose it was with the *knowledge or consent* of the old debtor, will Art. 1294 still apply?

ANS.:

- (a) Literally construed, it would seem that the Article will NOT apply; in other words, the old debtor would be liable.
- (b) But considering the intent of the law (and to distinguish *empromision* from *delegacion*), it is believed that the Article would still apply, that is, the old debtor would still *not be liable* for the new debtor’s insolvency or non-fulfillment.

Reason:

- 1) After all, the initiative did *not* come from him.
- 2) A contrary conclusion would put him in a worse position than in *delegacion*, where liability is only for insolvency and *not* for other kinds of non-fulfillment.

Art. 1295. The insolvency of the new debtor, who has been proposed by the original debtor and accepted by the creditor, shall not revive the action of the latter against the original obligor, except when said insolvency was already existing and of public knowledge, or known to the debtor, when he delegated his debt.

COMMENT:**(1) Effect of Insolvency by New Debtor in Delegacion**

- (a) This refers to *delegacion*.
- (b) Note that the Article deals only with insolvency, and not with other causes of non-fulfillment. (In said other causes, the old debtor is not liable.)

(2) Requisites to Hold Old Debtor Liable

For the old debtor to be liable if the new debtor is insolvent, it is required that either of the following must be present:

- (a) The insolvency was *already existing* and of PUBLIC KNOWLEDGE at the time of delegation;
- (b) OR the insolvency was *already existing* and KNOWN TO THE DEBTOR at the time of delegation.

(Note that if the insolvency occurred only AFTER the delegation, the old debtor is not liable.)

(3) Problem

A owes B P1,000,000. A proposed to B that C will pay A's debt, and that A will be released from all liabilities. B and C agree to the proposal. Later, when B tries to collect from A, he finds out that C is insolvent. It was proved that at the time of delegation, C was *already insolvent* but this was not known to A. Neither was the insolvency of public knowledge. Nevertheless, B still sues A on the ground that it was A who made the proposal, and that therefore A really guaranteed C's insolvency. Decide.

ANS.: A is NOT liable, for the insolvency was neither of public knowledge nor known to A at the time he delegated his debt. The law does not require A to give a blanket guaranty. (Art. 1295).

(4) When Article Does Not Apply

It is understood that Art. 1295 does NOT apply if there really was NO EXTINCTIVE NOVATION, such as:

- (a) When the third person was only an agent, messenger, or employee of the debtor.
- (b) When the third person acted only as guarantor or surety.
- (c) When the new debtor merely agreed to make himself *solidarily liable for the obligation*.
- (d) When the new debtor merely agreed to make himself *jointly or partly* responsible for the obligation. (Here the *delegation* is merely with reference to the joint or proportionate share.) (See 8 Manresa 435; Asiatic Petroleum Co. v. Yu Owa, [C.A.] 40 O.G. Supp. Oct. 11, 1941, p. 299; Rios v. Jacinto, 49 Phil. 7 and Garcia v. Khu Yek Chiong, 65 Phil. 466).

Art. 1296. When the principal obligation is extinguished in consequence of a novation, accessory obligations may subsist only insofar as they may benefit third persons who did not give their consent.

COMMENT:

(1) Effect on Accessory Obligation

Reason for the Article:

Extinguishment of the principal obligation carries with it the extinguishment of the accessory obligations (such as pledges, mortgages, guaranties). (*8 Manresa 441*).

[NOTE: Art. 1296 does not apply in cases of novation by subrogation of the creditor. (*See Art. 1303, Civil Code*).]

(2) Modificatory Novation

Art. 1296 applies in particular to *extinctive novation*. If the novation is merely *modificatory*, are guarantors and sureties released, if the novation is made WITHOUT their consent?

ANS.:

- (a) If the modified obligation is now MORE ONEROUS, they are liable only for the original obligation. (*See Art. 2054, Civil Code*).
- (b) If the modified obligation is now LESS ONEROUS, the guarantors and sureties are still responsible.

(3) Stipulation Contrary to Article 1296

May it be agreed that despite the extinguishment of the old obligation, the accessory obligations would still remain as accessory to the new obligation?

ANS.: Yes, provided that the debtors of said accessory obligations give their consent.

(4) Effect on Stipulation Pour Autrui

The rule given in Art. 1296 referring to the automatic extinction of all the accessory obligations speaks of one exception. What is this?

ANS.: Accessory obligations or stipulations made in favor of third persons (stipulations *pour autrui*) remain unless said third persons have their consent to the novation.

Reason: Their rights to the accessory obligations (which for them is really a *distinct* one) should not be prejudiced without their consent. (*See Art. 1311 of the Civil Code for examples of stipulations pour autrui.*)

Art. 1297. If the new obligation is void, the original one shall subsist, unless the parties intended that the former relation should be extinguished in any event.

COMMENT:

(1) Effect if the New Obligation Is Void

This Article highlights one of the essential requisites of a valid novation, namely, the new obligation must be **VALID** and **EFFECTIVE**. Thus, if the new obligation is void, there is no novation, and the old obligation generally will subsist.

(2) Other Factors

- (a) If the new obligation is subject to a condition and said condition does not materialize, the old obligation subsists.

Illustrative Case:

**Martinez v. Cavives
25 Phil. 581**

FACTS: *A* and *B* had a contract which they agreed to novate, provided the signatures of *C* and *D* could be obtained. But said signatures were never procured.

HELD: The old obligation subsists for failure of the novation.

- (b) If a new obligation was intended, but the new contract was never perfected for lack of the necessary consent, the old obligation continues. (*Vaca v. Kosca, 26 Phil. 388*).

(3) Rule if New Obligation Is Merely Voidable

Suppose the new obligation is *voidable*, what happens to the old obligation?

ANS.:

- (a) The old obligation is novated because a voidable obligation is valid until it is annulled.
- (b) If the new obligation is annulled, the old obligation subsists, and whatever novation has taken place will naturally have to be set aside. (*Encomienda v. Mendieta*, [CA] 8 A.C.R. 438).

Encomienda v. Mendieta
(C.A.) 8 A.C.R. 438

FACTS: A deed of sale was made validly. There was an attempt to novate the same by two new deeds containing, among other things, a provision for convention redemption. But one of the parties to the new deeds was a minor.

HELD: As to said minor, said new deeds are not valid and enforceable. Therefore, the original contract subsists.

(4) Exception to the Rule that There Is No Novation if the New Obligation Is VOID

One exception is when “the parties intended that the former relation should be extinguished in any event.” (*Art. 1297, Civil Code*).

(5) Problem

D and *C* entered into a contract whereby *D* was to give *C* P800,000 in cash. Later, they novated the contract by stipulating that instead of cash, *D* would give a particular car. Subsequently, the car was destroyed by a fortuitous event. Is *D* obliged to give P800,000?

ANS.: No, because the original obligation had already been extinguished by the valid novation. Moreover, the obligation to deliver the particular car is also extinguished because of the fortuitous event.

Art. 1298. The novation is void if the original obligation was void, except when annulment may be claimed only by the debtor, or when ratification validates acts which are voidable.

COMMENT:

(1) Effect if the Old Obligation Was Void

One of the requisites of a valid novation is that the obligation be valid. THEREFORE —

- (a) If the old obligation is VOID, there is no valid novation.
- (b) If the old obligation was VOIDABLE and has already been annulled, there is *no more* obligation. Therefore, the novation is also void.

(2) Rule if the Old Obligation Was Voidable

Suppose the old obligation was VOIDABLE and has not yet been annulled, may there be a valid novation?

ANS.: YES, provided that:

- (a) Annulment may be claimed only by the debtor;

Example: A was forced to sign a promissory note to give B P500,000. Later the parties agreed voluntarily to let the subject matter be a precious stone. Although the first contract was *voidable*, the second one is all right because in the first contract, annulment could be claimed only by the debtor.

- (b) Or when *ratification* validates acts which are voidable.

Example: An agent, acting without authority from his principal, bought merchandise from a company. Shortly after he had learned of his agent's act, the principal told the seller to deliver another kind of merchandise, completely different from the first. The seller agreed. Although the first contract here was unauthorized, ratification by the principal has cured its defects, and therefore the second contract is valid.

[NOTE: Although Art. 1298 speaks of a “void” original obligation, it evidently refers to a “VOIDABLE” one, where

annulment or ratification may exist. A void contract does not have to be annulled *nor* can it be ratified. (*Art. 1409, Civil Code*).]

(3) Rule if the Old Obligation Was Extinguished by Loss

May an old obligation that has been extinguished by LOSS of the subject matter be novated?

ANS.: It depends:

- (a) If the loss was purely because of a fortuitous event *without* liability on the part of the debtor, the novation is VOID for there would be NO obligation to novate.
- (b) If the loss made the debtor liable, there is still an existing monetary obligation that may be the subject of novation. (*See 8 Manresa 397-398*).

(4) May a Prescribed Obligation Be the Subject of Novation?

Yes, because unless the defense of prescription is set up by the debtor, the obligation continues, since this failure amounts to a WAIVER. (*Estrada v. Villareal, [C.A.] 40 O.G. [5th Supp.] p. 201*).

[NOTE: A prescribed debt, constituting as it does a moral or natural obligation, may be the cause or consideration of a new obligation to pay therefor. (*Villareal v. Estrada, 71 Phil. 140*).]

(5) Effect on a VOIDABLE Obligation of Novation by EX-PROMISION

- (a) Here the debtor is no doubt released from his obligation to the creditor, for the substitution was *not* done thru his initiative.
- (b) BUT when the new debtor, after payment, sues the old debtor for BENEFICIAL REIMBURSEMENT, the old debtor can set up whatever defenses he could have set against the creditor.

(*Example: the defense of minority or fraud*)

Art. 1299. If the original obligation was subject to a suspensive or resolutive condition, the new obligation shall be under the same condition, unless it is otherwise stipulated.

COMMENT:

(1) Effect if the Original Obligation Was Conditional

(a) *General rule*

The conditions attached to the old obligation are *also* attached to the new obligation.

(b) *Exception*

If there is a CONTRARY STIPULATION.

(2) Reason for the General Rule

If, for example, the suspensive condition attached to the obligation is NOT fulfilled, the old obligation never arose. Therefore, there would be *nothing to novate*, since novation requires the existence of a previous VALID and EFFECTIVE obligation.

(3) Illustrative Problems

- (a) A promised to give *B* a car if *B* should pass the bar exams. Later, both agreed that what should be given would be a diamond ring. Nothing was mentioned in the second contract regarding the condition. Is the new obligation also subject to a suspensive condition?

ANS.: Yes, unless it was otherwise stipulated in the new contract. The delivery of the diamond ring would, therefore, be due only after *B* has passed the bar exams.

- (b) A promised to give *B* a car unless *X* married *Y*. Later *A* and *B* agreed to change the object to a precious stone. No mention was made regarding any condition. Is the second obligation subject to a resolutive condition?

ANS.: Yes, unless the contrary has been provided for in the contract.

- (c) In question (b), supposing under the same facts, *X* had already married *Y* before *A* and *B* novated their contract, what happens to the new obligation?

ANS.: It is as if the new obligation never arose, for a contract that has already been extinguished cannot be novated.

Government v. Bautista
(CA) 37 O.G. No. 97, p. 1880

FACTS: Pilar T. Bautista mortgaged certain properties to the Postal Savings Bank. It was stipulated in the contract that Bautista could transfer the mortgage to anybody provided she complied with certain conditions and requirements (for example, the payment of the interest due, the transfer of title to the property to the assignee, a deposit of a certain amount, *etc.*). Thereupon, Bautista transferred the mortgage to Ocampo, without however fulfilling the requirements although repeated demands for their compliance had been made. The Bank made the same demands on Ocampo but still the requirements were not fulfilled. *Issue:* Has there really been a substitution of debtor here? Can the Bank still proceed to foreclose the mortgage as against Bautista?

HELD: There has been no valid substitution of debtor here and, therefore, no novation because the conditions were not fulfilled. Therefore also, Bautista remains the debtor, and the Bank can still proceed to foreclose the mortgage against her. This is true despite the unquestioned transfer of the mortgaged properties to Ocampo, because the letters of demand did *not* by themselves constitute sufficient reasons to release Pilar Bautista from her obligation.

Art. 1300. Subrogation of a third person in the rights of the creditor is either legal or conventional. The former is not presumed, except in cases expressly mentioned in this Code; the latter must be clearly established in order that it may take effect.

COMMENT:**(1) ‘Subrogation’ Defined**

Subrogation (extinctive subjective novation by change of the creditor) is the transfer to a third person of all the rights appertaining to the creditor, including the right to proceed against guarantors, or possessors of mortgages, subject to any legal provision or any modification that may be agreed upon. (See 8 Manresa 44).

(2) Kinds of Subrogation

(a) From the viewpoint of *cause or origin*:

- 1) *conventional or voluntary subrogation* (this requires an agreement and the consent of the original parties and of the creditor) (Art. 1301)
- 2) *legal subrogation* (this takes place by operation of law)

(b) From the viewpoint of *extent*:

- 1) *total subrogation*
- 2) *partial subrogation* (here, there would now be two or more creditors)

(3) Legal Subrogation Not Presumed

Legal subrogation is *not presumed*, except in the case expressly mentioned in the law. (See Art. 1302; see also *Panganiban v. Cuevas*, 7 Phil. 477).

(4) Conventional Subrogation Must Be Established

Conventional subrogation must be clearly *established*, otherwise, it is as if no subrogation has taken place.

Art. 1301. Conventional subrogation of a third person requires the consent of the original parties and of the third person.

COMMENT:

(1) Conventional or Voluntary Subrogation

For *conventional* or *legal* subrogation, the consent of ALL the parties is required:

- (a) *the debtor* — because he becomes liable under the new obligation; and because his old obligation ends
- (b) *the old creditor* — because his credit is affected
- (c) *the new creditor* — because he becomes a party to the obligation

(NOTE: Generally, the debtor loses the right to present against the new creditor any defense which he, the debtor, could have set up against the old creditor.)

(NOTE: As between conventional subrogation and assignment of the credit, the latter, insofar as the creditor is concerned, should be preferred, for it has advantages, without the corresponding disadvantages of conventional subrogation. Upon the other hand, conventional subrogation cannot present any advantage over assignment of credit.)

(2) Distinctions Between Conventional Subrogation and Assignment of Credit (See 8 Manresa, p. 448)

<i>ASSIGNMENT OF CREDIT</i>	<i>CONVENTIONAL SUBROGATION</i>
(a) here, there is mere transfer of the SAME right or credit (the transfer did not extinguish the credit)	(a) extinguishes the obligation, and creates a new one
(b) this does <i>not</i> require the debtor's consent (mere <i>notification</i> to him is sufficient)	(b) this requires the debtor's consent

(c) the defect in the credit or right is not cured simply by assigning the same (Here, the debtor generally <i>still</i> has <i>the right</i> to present against the new creditor any defense available as against old creditor.)	(c) the defect of the old obligation may be cured in such a way that the new obligation becomes entirely valid (Thus here, there is no right to present against the new creditor any defense which he, the debtor, could have set up against the old creditor.)
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(NOTE: The Court of Appeals in the case of *Cortes v. Phil. Trust Co.*, (C.A.) 45 O.G. No. 292, held, however, that an assignment of a savings deposit in a bank is *not* a withdrawal but a sort of subrogation, with the account being continued in the name of the assignee.)

Art. 1302. It is presumed that there is legal subrogation:

- (1) When a creditor pays another creditor who is preferred, even without the debtor’s knowledge;
- (2) When a third person, not interested in the obligation, pays with the express or tacit approval of the debtor;
- (3) When, even without the knowledge of the debtor, a person interested in the fulfillment of the obligation pays, without prejudice to the effects of confusion as to the latter’s share.

COMMENT:

(1) Legal Subrogation

This Article speaks of LEGAL subrogation. Under the old Code, the word “legal” was not present. It was inserted here for the sake of *clarity*.

(2) First Instance

“When a creditor pays another creditor who is preferred, *even without* the debtor’s knowledge.”

(a) *Example:*

Ligaya has two creditors: Gloria, who is a *mortgage* creditor for P1,500,000, and Solita, who is an *ordinary* creditor for P600,000. Solita, without Ligaya's knowledge, paid Ligaya's debt of P150,000 to Gloria. Here Solita will be subrogated in the rights of Gloria. This means that Solita will herself now be a *mortgage creditor* for P1,500,000, and an *ordinary* creditor for P600,000. If Ligaya fails to pay the P1,500,000 debt, Solita can have the mortgage foreclosed (that is, the property can be sold at public auction, with Solita being paid from the proceeds thereof).

(NOTE: The answer will be the SAME if Solita paid with Ligaya's knowledge.)

- (b) Suppose in the abovesited example, Solita paid Gloria only P1,300,000 for Ligaya's total indebtedness (Gloria agreed because of friendship), how much, concerning *this debt*, may Solita successfully recover from Ligaya?

ANS.: The whole P1,500,000 because concerning this debt, Solita steps completely into the shoes of Gloria.

- (c) Suppose in problem (b), Solita paid the P1,300,000 to Gloria without Ligaya's knowledge, but it turns out that at said time of payment, Ligaya's debt had already been reduced to P300,000 (because of a *prior partial* payment), how much can Solita successfully recover from Ligaya concerning this debt?

ANS.: Only said P300,000 because this is only the extent to which Ligaya had been benefited. It is Solita's fault that she did *not* first inform Ligaya of her intention to pay. Solita's remedy now would be to recover the excess amount from Gloria.

(NOTE: In legal subrogation caused by payment to a preferred creditor, may the debtor set up against the new creditor defenses which he, the debtor, could have set up against the old creditor?

ANS.: Yes, for after all, the subrogation took place by operation of law. This effect differs from the effect of CONVENTIONAL subrogation where the debtor gave *his consent*.)

(NOTE: Examples of such defenses are the following: causes of vitiated consent like force, intimidation, minority, undue influence, error; other causes like prior payment whether total or partial; remission; compensation, etc.)

[NOTE: For example of “preferred creditor” see Book IV, Title XIX of the Civil Code on Preference of Credits. (Art. 2241 and the following articles).]

(3) Second Instance

“When a third person, not interested in the obligation, pays with the *express* or *tacit* approval of the debtor.”

(a) *Example:*

Eubolo owes Luna P1,000,000 *secured by a mortgage*. Blesilda, a classmate of Eubolo, and having no connection with the contract at all, paid Luna the P1,000,000 with Eubolo’s approval. Is Blesilda subrogated in Luna’s place?

ANS.: Yes, because although *not* interested in the obligation, she nevertheless paid off Luna with the approval of the debtor. (Art. 1302, No. 2).

(b) If in the above example, Blesilda, who is Luna’s friend, paid her only P700,000 for the extinguishment of Eubolo’s debt, but the payment was made without the express or tacit approval of Eubolo, what would be Blesilda’s rights, if any?

ANS.: There is no legal subrogation here because there was no express or implied approval of Eubolo. Therefore, all that Blesilda can recover is P700,000 for this is the amount with which she is supposed to be REIMBURSED (a giving back to her of what she had DISBURSED). If Eubolo does NOT pay, Blesilda cannot have the mortgage foreclosed. For, as has been said, there has been no subrogation here.

(4) Third Instance

“When, even without the knowledge of a debtor, a person interested in the fulfillment of the obligation pays, without prejudice to the effects of confusion as to the latter’s share.”

(a) *Examples of persons “interested:”*

- 1) a guarantor
- 2) the owner of the property mortgaged as security for the debtor’s debt

(b) *Example of the Third Instance:*

D owes *C* P1,000,000 secured by a mortgage and by a guaranty of *G*. If *G*, even without *D*’s knowledge, pays *C* the P1,000,000, *G* will be subrogated in *C*’s place. But of course the guaranty is extinguished. This is what the law means when it says that there is legal subrogation “without prejudice to the effects of *confusion* as to the latter’s (payor’s) share in the obligation.” (*Art. 1302, par. 3*).

(c) Is a *solidary* debtor included in the scope of “a person interested?”

- 1) Strictly speaking, NO, because when the solidary debtor pays the whole obligation to the creditor, *solidary* obligation itself is extinguished. Therefore, it *cannot* be truly said that said solidary debtor steps *completely* into the shoes of the creditor. Moreover, although the other solidary debtors must reimburse him, this obligation to reimburse is not solidary, but *merely* joint, except of course that they are *all proportionately* liable in the meantime for the insolvency of one of them. (*See Wilson v. Berkenkotter, 49 O.G. 1401*).
- 2) In another (“loose”) sense, the solidary debtor may be said to fall under the category of an “interested person” in that he steps in a way into the shoes of the old creditor, since he would be entitled to COLLECT reimbursement, but of course he cannot collect the whole amount anymore in view of the “effect of confusion (or merger) as to his share.” (*See Art. 1217, Civil Code*).

Art. 1303. Subrogation transfers to the person subrogated the credit with all the rights thereto appertaining, either against the debtor or against third persons, be they guarantors or possessors of mortgages, subject to stipulation in a conventional subrogation.

COMMENT:**(1) Effects of Subrogation**

Note that the *credit* and all the *appurtenant rights*, either against the debtor, or against *third persons*, are *transferred* (thus, in a sense the obligation subsists, that is, it has *not* yet been extinguished or paid).

(2) Example of the Effects of Subrogation

D owes *C* P1,000,000. *G* is the guarantor. A stranger *S* paid *C* the P1,000,000 with the consent of *D* and *C*. *S* is now subrogated in the place of *C*. If *D* cannot pay the P1,000,000, *S* can proceed against the guarantor, *G*.

(3) Effect of Presence of a Suspensive Condition

It is understood that if the transferred credit is subject to a suspensive condition, the new creditor cannot collect until after said condition is fulfilled. (*See Gonzales Diez v. Delgado*, 37 Phil. 389).

Art. 1304. A creditor, to whom partial payment has been made, may exercise his right for the remainder, and he shall be preferred to the person who has been subrogated in his place in virtue of the partial payment of the same credit.

COMMENT:**(1) Partial Subrogation**

Here, there are two creditors:

- (a) the old creditor, who still remains a creditor as to balance (because only a partial payment has been made to him);
- (b) the new creditor who is a creditor to the extent of what he had paid the creditor.

(2) Example

A owes *B* P500,000. With the consent of both, *C* pays *B* P250,000. Now *B* and *C* are the creditors of *A* to the amount of P250,000. Suppose *A* has only P250,000 who should be preferred?

ANS.: *B*, the original creditor, should be preferred inasmuch as he is granted by the law (*Art. 1304, Civil Code*) preferential right to recover the remainder, over the person subrogated in his place by virtue of the partial payment of the same credit.

(3) Preference in the Assets

The preference is only in the assets remaining with the debtor (not those already transferred to others). (*Molina v. Somes, 31 Phil. 76*). Therefore, the old creditor must assert his claim or preference over the assets only while they are still in the hands of the sheriff who has levied on the properties. If done later, the preference given by this article CEASES. (*Molina v. Somes, 31 Phil. 76, referring to a prior case — Somes v. Molina, 15 Phil. 133*).

Somes v. Molina 15 Phil. 133

FACTS: *B* bought property from *X* on the installment plan (4 installments). *S* acted as surety (a guarantor who bound himself solidarily with *B*). When *B* failed to pay the first installment, *X* sued *B* and *S*, and the judgment was satisfied from *S*'s properties. Later, *B* again defaulted in the payment of the other installments, and judgment was entered against him. *S*, fearful for his rights, then brought an action to have himself declared subrogated in the rights of *X*. He did this because he wanted to be paid first, from the assets of *B*. In other words, he wanted to be preferred over *X*, the seller; he did not want *X* to be paid first for the judgment.

HELD: *S* cannot be preferred. As a matter of fact, it is *X* to whom the law grants preference because *X* is a creditor to whom only a *partial payment* has been made.

[NOTE: Indeed, there was only a *partial payment* because only one installment — of the same debt — had been paid. (See *Art. 1304*).]

TITLE II. — CONTRACTS

Chapter 1

GENERAL PROVISIONS

Art. 1305. A contract is a meeting of minds between two persons whereby one binds himself, with respect to the other, to give something or to render some service.

COMMENT:

(1) 'Contract' Defined

- (a) A *contract*, from the Latin "*contractus*" and from the French "contract," is "a juridical convention manifested in legal form, by virtue of which, one or more persons (or parties) bind themselves in favor of another or others, or reciprocally, to the fulfillment of a prestation to give, to do or not to do." (4 *Sanchez Roman* 148-149). "A contract is a meeting of minds between two persons whereby one binds himself with respect to the other, to give something or to render some service." (*Edilberto Alcantara v. Cornelio B. Rita, Jr.*, GR 136996, Dec. 14, 2001).
- (b) It is the agreement of two or more persons (or parties) for the purpose of creating, modifying, or extinguishing a juridical relation between them. (*Art. 1321, Italian Civil Code* and 2 *Castan* 184).

**Cronico v. J.M. Tuason & Co., Inc.
L-35272, Aug. 26, 1977**

Should a seller of lots on installment have two or more prospective buyers, it has a right to select the person to whom the property should be sold. This is particularly so,

because buyers who may be delinquent in the payment of monthly installments should be avoided, to prevent expensive suits in court. Here it appeared that the rejected buyer was one who by herself could not afford to pay, and who apparently was a “front” for someone else.

Radio Communications of the Phils., Inc. v. CA
GR 44748, Aug. 29, 1986

Everytime a person transmits a message through the facilities of a corporation engaged in the business of receiving and transmitting messages, a contract is entered into. Upon receipt of the rate or fee fixed, the corporation undertakes to transmit the message accurately.

(2) Elements of a Contract

- (a) *essential elements* — (without them a contract cannot exist)

(*Examples*: consent, subject matter, cause or consideration)

(*NOTE*: In some contracts, *form* is also essential; still in others, *delivery* is likewise essential.)

- (b) *natural elements* — (those found in certain contracts, and presumed to exist, unless the contrary has been stipulated)

(*Example*: *warranty against eviction* and against *hidden defects* in the contract of sale)

- (c) *accidental elements* — (These are the various particular stipulations that may be agreed upon by the contracting parties in a contract. They are called accidental, because they may be present or absent, depending upon whether or not the parties have agreed upon them.)

(*Examples*: the stipulation to pay credit; the stipulation to pay interest; the designation of the particular place for delivery or payment.)

(3) Classification of Contracts

- (a) According to *perfection or formation*:

- 1) *consensual* (perfected by *mere consent*; *example* — sale)
- 2) *real* (perfected by delivery; *examples* — *depositum*, *pledge*, *commodatum*). (Art. 1316, Civil Code).
- 3) *formal* or *solemn* (those where special formalities are essential before the contract may be perfected) (*Example*: A donation *inter vivos* of real property requires for its validity a *public instrument*.)

Serrano v. Central Bank, et al.
L-30511, Feb. 14, 1980

Bank deposits are in the nature of irregular deposits. They are really loans because they earn interest. All kinds of bank deposits, whether fixed, savings, or current, are to be treated as loans and are to be covered by the law on loans. Failure of the bank to honor the time deposit is failure to pay its obligation as a debtor, and not a breach of trust arising from a depositary's failure to return the subject matter of the deposit.

- (b) According to *cause* or *equivalence of the value of prestations*:
 - 1) *onerous* — where there is an interchange of *equivalent* valuable consideration
 - 2) *gratuitous* or *lucrative* — this is FREE, thus one party receives no equivalent prestation except a feeling that one has been generous or liberal
 - 3) *remunerative* — (one where one prestation is given for a benefit or service that had been rendered PREVIOUSLY)
- (c) According to *importance or dependence of one upon another*:
 - 1) *principal* (here, the contract may stand alone by itself; *examples*: sales, lease)
 - 2) *accessory* (this depends for its existence upon another contract; *example*: mortgage) (Here the principal contract is one of LOAN.)

- 3) *preparatory* (here, the parties do not consider the contract as an end by itself, but as a means thru which future transaction or contracts may be made; *examples*: agency, partnership)
- (d) According to the *parties obligated*:
 - 1) *unilateral* [where only one of the parties has an obligation; *example*: *commodatum* (like the borrowing of a bicycle)]

(*NOTE*: Even here, the *giving of consent* must be mutual or *bilateral*.)
 - 2) *bilateral* (or *synalagmatic*) (here, both parties are required to render reciprocal prestations; *example*: sale)
- (e) According to their *name or designation*:
 - 1) *nominate* — (here the contract is given a particular or special name; *examples*: *commodatum*, partnership, sale, agency, deposit)

Guingona, Jr. v. City Fiscal of Manila
L-60033, Apr. 4, 1984

If one opens a time or savings deposit with a bank, the contract is one of simple loan or *mutuum*, not a contract of deposit. Ownership of the deposited funds is transferred to the bank from the moment the contract is perfected.

- 2) *innominate* — (also called *contratos innominados*) those not given any special name; *example*: “*do ut des*,” meaning “I give that you may give”)
- (f) According to the *risk of fulfillment*:
 - 1) *commutative* — (here the parties contemplate a *real* fulfillment; therefore, equivalent values are given; *examples*: sale, lease)
 - 2) *aleatory* — (here the fulfillment is dependent upon *chance*; thus the values vary because of the risk or chance; *example*: an insurance contract)
- (g) According to the *time of performance or fulfillment*:

- 1) *executed* — (one completed at the time the contract is entered into, that is, the obligations are complied with at this time; *example*: a sale of property which has already been delivered, and which has already been paid for)

(NOTE: In the case of personal property, this results in tangible property itself, a “*chose in possession.*”)

- 2) *executory* — (one where the prestations are to be complied with at some future time; *example*: a perfected sale, where the property has *not* yet been delivered, and where the price has not yet been given) (In the meantime, there is only a “*chose in action.*”)

(NOTE: If the whole or a part of the property or the price has been delivered, the contract may be said to be “*partially executed.*”)

(h) According to *subject matter*:

- 1) contracts involving *things* (like SALE)
- 2) contracts involving *rights* or *credits* (provided these are transmissible, like a contract of *usufruct*, or *assignment of credits*)
- 3) contracts involving *services* [like agency, *lease of services*, a contract of common carriage, a contract of carriage (*simple carriage*)]

National Power Corp. v. EIN
GR 24856, Nov. 14, 1986

FACTS: NPC awarded EIN the contract to deliver crude sulfur in one shipment on or before May 10, 1956. A bond posted by the PIS guaranteed the obligation. EIN obtained from NPC a letter of credit on May 8, 1956. Upon request of EIN, the NPC reset the letter of credit to Jun. 30, 1956. Upon EIN's further request, the NPC extended the expiry date of the letter of credit to Dec. 30, 1956. On Aug. 19, 1956, EIN delivered 1,000 of the agreed 3,691 long tons of sulfur ostensibly due to lack of bottoms. NPC sued

EIN for damages. The lower court dismissed the case declaring that EIN did not act in bad faith.

HELD: The extensions of the expiry date of the letter of credit cannot be interpreted as extensions of delivery date. There is no relationship between delivery date and opening of letter of credit which was opened within a reasonable time after the signing of the contract. NPC has been lenient by extending the expiry date of the letter of credit. The problem of bottoms is well-known and the NPC cannot be faulted for such problem. EIN committed a breach of contract by failing to completely deliver on its contract.

(i) According to *obligations imposed and regarded by the law*:

- 1) *ordinary* — (like sale; the law considers this as an *ordinary contract*)
- 2) *institutional* — [like the contract of marriage; the law considers marriage also as an “inviolable social institution.” (*Art. 52, Civil Code*).]

(NOTE: Under Art. 1700 of the Civil Code, the law says that “the relations between *CAPITAL* and *LABOR* are not merely contractual. They are so impressed with public interest that labor contracts must yield to the common good.”)

(j) According to the *evidence required for its proof*:

- 1) those requiring merely *oral* or *parol* evidence

**Lao Sok v. Sabaysabay
GR 61898, Aug. 9, 1985**

Even an oral contract is binding on the parties, unless form is essential for its validity and enforceability. Thus, the employer’s offer to pay the employee’s separation pay is a perfected contract.

- 2) those requiring written proof (*example*: contracts enumerated under the Statute of Frauds)
- (k) According to the *number of persons actually and physically entering into the contracts*:

- 1) *ordinary* — (where two parties are represented by different persons; *example*: sale)
- 2) *auto-contracts* — (where only one person represents two opposite parties, but in *different* capacities; *example*: an agent representing his principal sells a specific car to himself, as a buyer)

[NOTE: Such a contract is valid, for the law does not expressly prohibit same except in certain specified cases. Thus, an agent who has been authorized to lend money from his principal *cannot borrow* it without the consent of the principal; but if he has been empowered to borrow money, he may himself be the lender at the current rate of interest. (*Art. 1890, Civil Code*).]

- (1) According to the *number of persons who participated in the drafting of the contract*:
 - 1) *ordinary* — (like an ordinary sale)
 - 2) *a contract of adhesion* (like one prepared by a real estate company for the sale of real estate; or one prepared by an insurance company) (Here, the buyer, or the person interested in being insured, signifies his consent by signing the contract. If he does not desire to enter into the contract, it is his privilege to refuse.)

Sweet Lines, Inc. v. Bernardo Teves, et al.
L-37750, May 19, 1978

By the peculiar circumstances under which contracts of adhesion are entered into — namely, that it is drafted only by one party, usually the corporation, and is sought to be accepted or adhered to by the other party, in this instance the passengers, private respondents, who cannot change the same and who are thus made to adhere hereto on the “take it or leave it” basis — certain guidelines in the determination of their validity and/or enforceability have been formulated in order to ensure that justice and fair play characterize the relationship of the contracting parties. It is a matter of public knowledge, of which

we can take judicial notice [of], that there is a dearth and acute shortage of inter-island vessels plying between the country's several islands, and the facilities they offer leave much to be desired. Thus, even under ordinary circumstances, the piers are congested with passengers and their cargo waiting to be transported. The conditions are even worse at peak and/or rainy seasons, when passengers literally scramble to secure whatever accommodations they may avail of, even through circuitous routes, and/or at the risk of their safety. Under these circumstances, it is hardly just and proper to expect the passengers to examine their tickets received from crowded/congested counters, more often than not, during rush hours, for conditions that may be printed thereon, much less charge them with having consented to the conditions so printed, especially if there are a number of such conditions in fine print, as in this case.

It should also be stressed that shipping companies are franchise-holders of certificates of public convenience and, therefore, possess a virtual monopoly over the business of transporting passengers between the ports covered by their franchise. This being so, shipping companies have a virtual monopoly of the business of transporting passengers and may thus dictate their terms of passage, leaving passengers with no choice but to buy their tickets and avail of their vessels and facilities. Finally, judicial notice may be taken of the fact that the bulk of those who board these inter-island vessels come from the low-income groups and are less literate, and who have little or no choice but to avail of petitioner's vessels.

Angeles v. Calasanz
GR 42283, Mar. 18, 1985

A contract of adhesion is so called because its provisions are drafted by only one party, usually a corporation, and the only participation of the other party is to sign his name, his signature or his "adhe-

sion” to the contract. Insurance contracts, bills of lading, contracts of sale of lots on installment plan fall into this category. A contract to sell, drafted and prepared by the seller and offered on a “take-it-or-leave-it” basis to the buyers, who, being too eager to acquire a lot upon which they could build their home and without having had the chance to question or change any of the terms of the agreement, assented to its terms and conditions and affixed their signatures, has some characteristics of a contract of adhesion.

The terms of a contract of sale which has the characteristics of a contract of adhesion must be construed and interpreted against the party who drafted it, especially if the interpretation will help effect justice to buyers who, after having invested a big amount of money, are sought to be deprived of the same through the application of a contract, clever in its phraseology, condemnable in its lopsidedness and injurious in its effect which, in essence, and in its entirety, is most unfair to the buyers.

Arquero v. Hon. Flojo and RCPI
GR 68111, Dec. 20, 1988

FACTS: On Nov. 27, 1983, the petitioner and private respondent Radio Communications of the Phils., Inc. (RCPI), entered into a contract for services for the transmission of a telegraphic message thru RCPI’s branch office in Aparri, Cagayan to Atty. Eleazar S. Calasan at his office address in Quiapo, Manila. The text of the telegram contract form for transmission (as well as the telegram itself) reads:

“Send the following message subject to the condition that the RCPI shall not be liable for any damage, howsoever, same may arise except for the refund of telegraph tolls. The sender agrees that a condition precedent for a cause of action against the RCPI any complaint relative to the transmittal of this telegram must be

brought to the attention of the company within three months from date, and the venue thereof shall be in the courts of Quezon City alone and in no other courts.

ATTY. CALASAN
ROOM 401 PAYAWAL BLDG.
709 PATERNO, QUIAPO, MANILA

CONGRATULATIONS PREPARE ONE
XEROX COPY DECISION SEE YOU BONI'S
BIRTHDAY

BERNOLI"

Atty. Eleazar S. Calasan received a copy of the telegram the next day but he was made to pay the sum of P7.30 for delivery charges. Thereafter, on Nov. 30, 1983, at the birthday party of Asst. Fiscal Bonifacio Sison in Quezon City, Atty. Calasan confronted and censured the petitioner anent the said telegram. Despite the petitioner's explanation that the telegram had been duly paid for, he was branded as a "stingy Mayor who cannot even afford to pay the measly sum of P7.30 for the telegram," in the presence of many persons. Thus, the petitioner filed an action for damages against RCPI before the Regional Trial Court of Aparri, Cagayan. RCPI filed a motion to dismiss on the ground of improper venue, contending that pursuant to the service contract, the parties had agreed that the venue of any action which may arise out of the transmittal of the telegram shall be in the courts of Quezon City alone.

On Feb. 13, 1984, the trial court dismissed the case and denied the motion for reconsideration *re* said dismissal. Hence, the instant petition. Citing the case of *Sweet Lines, Inc. v. Bernardo Teves, et al.*, 83 SCRA 361, the petitioner claims that the condition with respect to venue appearing on the ready printed form of RCPI's telegram for transmission is void and unenforceable because the petitioner had no hand in

its preparation. The *Court* there held that contracts of adhesion where the provisions have been drafted only by one party and the only participation of the other party is the signing of his signature or his adhesion thereto, are contrary to public policy, as they are injurious to the public or public good.

HELD: The agreement of the parties in the case at bar as to venue is not contrary to law, public order, public policy, morals or good customs. The parties do no dispute that in the written contract sued upon, it was expressly stipulated that any action relative to the transmittal of the telegram against the RCPI must be brought in the Courts of Quezon City alone. We note that neither party to the contract reserved the right to choose the venue of action as fixed by law, *i.e.*, where the plaintiff or defendant resides, at the election of the plaintiff (Sec. 2, Rule 4, Rules of Civil Procedure), as is usually done if the parties purported to retain that right of election granted by the Rules. Such being the case, it can reasonably be inferred that the parties intended to definitely fix the venue of action, in connection with the written contract sued upon in the courts of Quezon City only. Section 3, Rule 4, Revised Rules of Court sanctions such stipulation by providing that "by written agreement of the parties the venue of action may be changed or transferred from one province to another." (*Bautista v. de Borja*, 18 SCRA 474).

In the instant case, the condition with respect to venue in the telegram form for transmission was printed clearly in the upper front portion of the form. Considering the petitioner's educational attainment (being a lawyer by profession and the Municipal Mayor of Sta. Teresita, Cagayan), he must be charged with notice of the condition limiting the venue to Quezon City, and by affixing his signature thereon, he signified his assent thereto. Thus, the ruling in *Sweet Lines, Inc. v. Teves, et al.*, is not applicable in this case.

BPI Express Card Corp. v. Eddie C. Olalia
GR 131086, Dec. 14, 2001

FACTS: Petitioner BPI Express Card Corp. (BECC) operates a credit card system thru which it extends credit accommodations to its cardholders for the purchase of goods and other services from member-establishments of petitioner to be reimbursed later by the cardholder upon proper billing.

Respondent Eddie C. Olalia was a credit cardholder with a credit limit of P5,000. When Olalia's credit card expired, a renewal card was issued. An extension card was also issued to Olalia's wife, Cristina. The extension card of Cristina was used for purchases made from Mar. to Apr. 1991, particularly in the province of Iloilo and Bacolod City. Total unpaid charges from the use of this card amounted to P101,844.54. Olalia denied having applied for, much less receiving the extension card. He further alleged that his wife, from whom he was already divorced, left for the United States in 1986 and has since resided there. In addition, neither he nor Cristina was in Bacolod or Iloilo at the time the questioned purchases were made. He admitted responsibility for the amount of P13,883.27, representing purchases made under his own credit card.

A case for collection was filed against Olalia. The trial court initially found Olalia liable for the amount of P13,883.27 only. On motion for reconsideration filed by petitioner, the trial court ordered Olalia to pay the sum of P136,290.97. On appeal, the Court of Appeals (CA) sustained Olalia and made him liable for only P13,883.27 with interest at 3% per month in addition to a penalty fee of 3% of the amount due every month, until full payment. Hence, this petition.

HELD: Petition is denied and with the CA's decision being affirmed.

Contracts of this nature are contracts of adhesion, so-called because their terms are prepared by

only one party while the other merely affixes his signature signifying his adhesion thereto. As such, their terms are construed strictly against the party who drafted it. In this case, it was BECC who made the foregoing stipulation, thus, they are now tasked to show vigilance for its compliance.

(m) According to the *nature* of the contract:

- 1) personal
- 2) impersonal

Insular Life Assurance, Ltd. v. Ebrado
80 SCRA 181

The contract of life insurance is an example of a “personal” contract. (This is because upon the *death* of the insured, the contract ceases to exist. Indemnities, in the proper case will, of course, be given.)

(4) Stages of a Contract

- (a) *Preparation (or Conception or “Generacion”)* — Here the parties are progressing with their negotiations; they have not yet arrived at any definite agreement, although there may have been a preliminary offer and bargaining.
- (b) *Perfection (or birth)* — Here the parties have at long last came to a definite agreement, the elements of definite subject matter and valid cause have been accepted by mutual consent.
- (c) *Consummation (or death or termination)* — Here the terms of the contract are performed, and the contract may be said to have been fully executed.

(5) Parties to a Contract

- (a) The law speaks of a meeting of minds between two “persons.” The meeting of the minds really refers to two “parties.” If at the time of supposed perfection, one of the parties had already previously died, there can be no meeting of the minds; hence, no contract. (*Coronel v. Ona*, 33 Phil. 456).

Marimperio Compania Naviera, S.A. v. CA
GR 40234, Dec. 14, 1987

A contract takes effect between the parties who made it, and also their assigns and heirs, except in cases where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation, or by provision of law. Since a contract may be violated by the parties thereto, as against each other, in an action upon that contract, the real parties in interest, either as plaintiff or as defendant, must be parties to said contract. Therefore, a party who has not taken part in it cannot sue or be sued for performance or for cancellation thereof, unless he shows that he has a real interest affected thereby.

Baliwag Transit, Inc. v. CA and
Spouses Sotero Cailipan, Jr. and
Zenaida Lopez and George L. Cailipan
GR 80447, Jan. 31, 1989

Since a contract may be violated only by the parties thereto, as against each other, in an action upon that contract, the real parties-in-interest, either as plaintiff or as defendant, must be parties to said contract. A real party-in-interest-plaintiff is one who has a legal right, while a real party-in-interest-defendant is one who has a correlative legal obligation whose act or omission violated the legal right of the former. In the absence of any contract of carriage between the common carrier and the parents of the injured party, the latter are not real parties-in-interest in an action for breach of that contract.

The general rule of the common law is that every action must be brought in the name of the infringed. For the immediate wrong and damage, the person injured is the only one who can maintain the action. The person who sustains an injury is the person to bring an action for the injury against the wrongdoer.

- (b) While a promissory note is *unilateral* (in that only one party has signed it and is bound thereby), still such a contract includes two parties (the debtor and the creditor). Thus,

the signer is not the only party, nor the only one who can sue on such a contract. There can be *no obligor without an obligee*. (*Dilag v. Heirs of Fortunato Resurreccion*, 76 Phil. 650).

- (c) The meeting of the minds may arise because of an *express* or *implied* accord (such as when services as an interpreter and guide, whether solicited or not, were accepted and duly rendered; here, an obligation to pay for such services exists). (*See Perez v. Pomar*, 2 Phil. 682).

(6) Basic Principles or Characteristics of a Contract

- (a) *Freedom (or liberty) to Stipulate* (provided not contrary to law, morals, good customs, public order, or public policy). (*Art. 1306, Civil Code*).
- (b) *Obligatory Force and Compliance In Good Faith*. (*Arts. 1159 and 1315, id.*).
- (c) *Perfection by Mere Consent (Consensuality)* as a rule. (*Art. 1315, id.*).
- (d) *Both Parties are Mutually Bound*. (*Art. 1308, id.*).
- (e) *Relatively* (Generally, it is binding only between the parties, their assigns, and heirs). (*Art. 1311, id.*).

(7) Co-existence of a Contract with a Quasi-Delict (Tort)

The existence of a contract between the parties does not constitute a bar to the commission of a tort by one against the other, and the consequent recovery of damages. (*Araneta v. de Joya*, L-25172, May 24, 1974).

(8) Legal Effects of a Contract — How Determined

**Adoracion E. Cruz, et al. v. CA &
Spouses Eliseo & Virginia Malolos
GR 126713, Jul. 27, 1998**

Contracts constitute the law between the parties. They must be read together and interpreted in a manner that recon-

ciles and gives life to all of them. The intent of the parties, as shown by the clear language used, prevails over *post facto* explanations that find no support from the words employed by the parties or from their contemporary and subsequent acts showing their understanding of such contracts. A subsequent agreement cannot novate or change by implication a previous one, unless the old and new contracts are, on every point, incompatible with each other.

Indeed, the legal effects of a contract are determined by extracting the intention of the parties from the language they used and from their contemporaneous and subsequent acts. This principle gains more force when third parties are concerned. To require such persons to go beyond what is clearly written in the document is unfair and unjust. They cannot possibly delve into the contracting parties' minds and suspect that something is amiss, when the language of the instrument appears clear and unequivocal.

(9) Delivery of the Thing

People v. Lacap GR 139114, Oct. 23, 2001

FACTS: Accused-shabu supplier, a former military officer trained in narcotics operation, anti-terrorism, and military tactics denied the existence of any buy-bust operation, and alleged that the whole operation was a frame-up. The lower court convicted the supplier. On appeal, he contended that there was no actual delivery of the drug to the poseur-buyer, thus, he should be acquitted of the charge because one of the elements of the crime had not been established. There are two (2) elements necessary for the prosecution of the crime of illegal sale of shabu under Sec. 15, Art. III of RA 6425, as amended by Sec. 20, Art. IV of RA 7659, namely: (1) identity of buyer and seller, object, and consideration; and (2) delivery of thing sold and payment therefor. *Issue:* Was the supplier correct in his contention?

HELD: No. Although the supplier did not actually hand the contraband to the buyer, he placed it on top of the vault where the latter could have easily gotten it after paying him. There was, thus, a constructive delivery of the drug. The fact that the

supplier tried to put the shabu back inside the vault is of no moment as the crime had by then been already consummated. There is no rule which requires that in a buy-bust operation there must be a simultaneous exchange of the money and the drug the poseur-buyer and the pusher. Nor was it important that the “boodle” money was not presented in court. What is material to the prosecution of the illegal sale of dangerous drugs is proof that the transaction actually took place with the presentation in court of the *corpus delicti* or the substantial fact that a crime has been committed.

(10) ‘Reforestation’ Contract

**Bataan Seedling Association, Inc. v. Republic
of the Philippines
GR 141009, Jul. 2, 2002**

FACTS: Under the reforestation contract, petitioners were to turn over at the end of the third year the project area fully planted and properly maintained. However, the Project Development Plan, appended and made integral part of the contract, specifically defines and details petitioners’ undertaking. Under the Plan, the following tasks were to be completed during the first year of the project:

- (1) survey and mapping of the whole 50 hectares;
- (2) nursery operations for fast-growth, medium-growing, and slow-growth species;
- (3) plantation establishment, including site preparation, spot hoeing, staking, holing , and planting and seed transporting of 83,333 pieces, medium-sized seedlings and sucklers in planting holes; and
- (4) infrastructure work, including the development of foot path, graded trail, plantation road, bunkhouse, and look-out tower.

Spread out during the 3-year period is the annual maintenance, protection, administration and supervision, and monitoring and evaluation of the project area. *Issue:* Whether petitioners’ argument that they are not bound to fully plant/establish the

whole 50 hectares during the first year of operations is meritorious?

HELD: The argument is without merit. Clearly, based on said schedule, petitioners were to undertake the principal task of planting the 50 hectare-project area during the first year of the project. What is to be carried out during the entire 3-year period is the maintenance and aftercare of the project site, and petitioners were to turn over the project at the end of the third year fully planted and established.

Art. 1306. The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy.

COMMENT:

(1) The Principle of Freedom

This Article stresses the principle of *freedom*. The free entrance into contracts generally without restraint is one of the liberties guaranteed to the people. (*People v. Pomar*, 46 Phil. 440). However, the constitutional prohibition against the impairment of contractual obligations refers only to contracts which are legal, *not* to void or inexistent ones. (*San Diego v. Mun. of Naujan*, L-9920, Feb. 29, 1960).

**Denila, Gubatanga and Inayan v. Bellosillo
L-39569, May 16, 1975
(Litigants May Enter Into a Contract of Compromise)**

FACTS: To put an end to a case pending before the Court of Agrarian Relations in Iloilo, the parties thereto (the Beaterio del Santisimo Rosario de Molo, owner of a 13-hectare riceland and its tenants, Denila, Gubatanga, and Inayan) entered into a judicial compromise on Apr. 24, 1972 whereby the landowner agreed to cede by way of CIVIL LEASE (not agricultural lease or lease tenancy) to the latter certain parts of the land for two agricultural years, with the rentals therefor being specified. The contract also stated that should the rent be unpaid, the landowner will have the right to put an end to the lease and to ask

for a writ of execution whereby possession would be returned to the landowner. Because the rent was not paid, landowner moved for a writ of execution. Tenants alleged that in view of the existence of a *civil lease*, the Agrarian Court has lost jurisdiction over the case, and hence, can no longer issue a writ of execution, and that finally, they can be ejected from the land only in an unlawful detainer suit instituted in the proper municipal court. *Issue*: Does the CAR (Court of Agrarian Relations) still have jurisdiction to issue the writ applied for?

HELD: Yes, the CAR has such jurisdiction. Since originally it had jurisdiction because of the agrarian conflict, said jurisdiction *continues* until the case is finally ended. And the case can end precisely by the issuance and enforcement of a writ of execution (an enforcement contemplated by the parties). The compromise agreement is a contract binding on the parties and an admission by them of the just determination of their rights. Being embodied in a court judgment, it has upon the parties the effect and authority of *RES JUDICATA*, enforceable by a writ of execution. Indeed, the CAR, being vested with jurisdiction to render the decision based on the compromise agreement, has the power and authority to enforce it in the same case. It is not right for a party who had invoked the court's jurisdiction in order to procure a particular relief to deny afterwards that same jurisdiction so as to avoid a writ of execution.

**Clarita Tankiang Sanchez v. Court
of Appeals & Pedro Cristobal
L-22675, Jun. 22, 1984**

If the owner of agricultural land enters into a civil law lease with a lessee, and the latter hires laborers, the laborers cannot claim security of tenure if they are dismissed by the lessee. The relationship is not governed by the Agricultural Tenancy Act but by both the lease contract and the provisions of the Civil Code.

(2) Limitations on the Nature of the Stipulations

- (a) the law
- (b) morals

- (c) good customs
- (d) public order
- (e) public policy

In the case of *Abe, et al. v. Foster Wheeler Corporation, et al.*, L-14785, Nov. 29, 1960 and L-14923, Nov. 29, 1960, the appellant companies contended that as the contracts of employment were entered into at a time when there was NO law granting the workers one month pay, the application as to them of RA 1052 *restoring* the same right constitutes an impairment of their contractual obligations. There is no merit in this contention. The freedom of contract under the present system of government is NOT meant to be absolute. The same is understood to be subject to reasonable legislative regulations aimed at the promotion of public health, morals, safety, and welfare. In other words, the constitutional guaranty of non-impairment of obligations is limited by the exercise of the police power of the State. The question then to be determined is whether RA 1052 is a regulatory measure, not a substantive law, so that its enactment may properly be considered a valid exercise of police power. The answer is in the *affirmative*. The Act prescribes the manner of terminating employment, that is, without a fixed or definite period by requiring the employer or employee, before terminating such employment, to notify the other party of such fact. Evidently, the purpose is to give the other party opportunity to find replacement, in the case of the employer, and another place of employment, in the case of the employee. The right to be thus notified can hardly be considered substantive. The act is merely REGULATORY.

Ochengco v. City Court of Zamboanga
L-44657, Jan. 11, 1980

Even under PD 20 (regulating rentals of P300 or less a month), a lessor is allowed to sell his land in case of extreme necessity, as when he is 75 years old, sick, needs money for his illness, and is jobless. He is exempt from the suspension decreed in PD 20. In fact, the monthly rent here of P500 is a mere pittance, and the lease may be considered a gratuitous one. Besides, the lessee is much better off than the latter because he (lessee) owns a much bigger land in the city. The decree is precisely designed to alleviate the living conditions of those in need.

(3) Limitations Imposed by Law

- (a) The contractual stipulations must not be contrary to *mandatory* and *prohibitive* laws. (*Art. 5, Civil Code*). *Directory* and *suppletory* laws need not be complied with, since these are either discretionary, or merely supply the omissions of the parties. (*8 Manresa 620*).
- (b) Contracts must respect the law, for the law forms part of the contract. Indeed, the provisions of all laws are understood to be incorporated in the contract. (*Commissioner of Int. Revenue v. United Lines Co., L-16850, May 20, 1962*). [Thus, the right to *overtime compensation* and to wages, although granted by law, is nevertheless *implicitly included* in every *contract of employment*; and therefore the prescriptive period is that provided for *contracts, oral or written*, as the case may be, and not the prescriptive period for enforcing a right given by law. (*Flores, et al. v. San Pedro, et al., L-8580, Sept. 30, 1957*).]

(NOTE: This is without prejudice to RA 193.)

RCPI v. CA
GR 44748, Aug. 29, 1986

If libelous matters are included in the message transmitted, without the consent or knowledge of the sender, the company commits a breach of contract.

- (c) In a mortgage contract, a *pactum commissorium* (a clause providing that the mortgagee will automatically own the property mortgaged if the debt is not paid at maturity) is null and void. (*Art. 2088, Civil Code; 8 Manresa 620-621*).

(NOTE: The mortgage itself, however, remains valid.)

- (d) Likewise, an “upset price” is *not* allowed in a mortgage contract. An upset price is a specified price below which the mortgaged property is not supposed to be sold at the execution sale. (*Warner, Barnes and Co. v. Jaucian, 13 Phil. 4*).
- (e) The parties to a contract *cannot* deprive a competent court of its jurisdiction, because *jurisdiction* is fixed by law, and not by the will of the parties. (*Molina v. De la Riva, 6 Phil. 12*). However, *venue*, or the place where the action may be

brought, can be the subject of stipulation. (*Rule 4, Sec. 4, Revised Rules of Court and Central Azucarera v. De Leon, 56 Phil. 169*).

Palma v. Canizares
1 Phil. 602

FACTS: D lost in gambling and as payment, executed a promissory note in favor of the winner *C*. *C* then assigned the note to *A*. *Issue: May A* successfully recover from *D*?

HELD: No, because the promissory note is void. Just as the winner cannot recover, so also cannot the assignee.

(*NOTE: If the loser had borrowed money from a friend thru a promissory note, said money to be used to pay the winner, the promissory note is valid for it was not the result of gambling between the loser and the friend. Thus, while a winner in gambling cannot recover, a friend who lends the money can recover.*)

Cabatan v. Court of Appeals
L-44875-76, L-45160, L-46211-12
Jan. 22, 1980

The contract of the parties must conform with the law in force at the time the contract was executed. Since at the time the contracts were entered into there was as yet no statute fixing a ceiling on rentals and prohibiting the lessor from demanding an increase thereof, the lessor had the right to do so.

(4) Limitations Imposed by Morals

- (a) Morals deal with right and wrong (*See De los Reyes v. Alojado, 16 Phil. 499*) and with human conscience. (*Ibarra v. Aveyro, 33 Phil. 273*).

De los Reyes v. Alojado
16 Phil. 499

FACTS: A debtor agreed to work as a servant for her creditor WITHOUT PAY until she could find money with

which to pay her debt. After sometime she left without paying, so the creditor instituted this action to compel her to pay, and work as a servant without pay 'til the debt could finally be paid. The debtor, on the other hand, asked payment for services already rendered.

HELD: The agreement to work without pay is immoral and void since this would amount to involuntary servitude. The creditor was ordered to pay wages and to subtract therefrom the amount of the debt.

Emeterio Cui v. Arellano University
2 SCRA 205

FACTS: A student who had finished 3 1/2 semesters in the College of Law of the Arellano University *transferred* to another law school for his last semester. For the 3 1/2 semesters he stayed at the Arellano University, he enjoyed a *scholarship*; hence, was not required to pay fees. When he sought transfer and his transcript of grades, he was asked to *reimburse* all the scholarship funds since, the agreement *precisely provided for a refund in case of transfer*. *Issue:* Is such a *proviso* valid?

HELD: The *proviso* is *void*, and contravenes both morals and public policy. Scholarships should not be propaganda matter; they are awards for merit. Hence, the student need *not* reimburse.

Ibarra v. Aveyro
37 Phil. 273

A penalty clause providing for the payment of P5 for each day's delay after the maturity of a loan for P465 was held immoral inequitable, shocking to the human conscience, and void.

Batarra v. Marcos
7 Phil. 156

A promise of marriage based on a *carnal* consideration is immoral and, therefore, void.

Gorospe, et al. v. Gochangco
L-12735, Oct. 30, 1959

Excessive or unreasonable attorney's fees even if stipulated in a contract must be reduced, for a lawyer is primarily a court officer, subject to judicial control.

Saturnino Selanova v. Alejandro E.
Mendoza, Adm. Matter-804-CJ
May 19, 1975

FACTS: A judge (and notary public) prepared and ratified a document dated Nov. 21, 1972, *liquidating extra-judicially a conjugal partnership* and allowing the married couple concerned *to waive their right to prosecute each other for future acts of infidelity*. *Issue:* Are said stipulations in the public instrument considered valid?

HELD: Both stipulations are contrary to law, good customs, morals, and public policy, and the notarizing official can therefore be punished administratively.

While it is true that in *Lacson v. San Jose-Lacson*, *L-23482*, *L-23767*, and *L-24259*, Aug. 30, 1968, 24 SCRA 837, such an extrajudicial agreement for dissolution can be made during the marriage, still the judicial sanction must be obtained BEFOREHAND, not subsequently.

The license given to either spouse to commit any act of infidelity was, in effect, a ratification of their personal separation and, therefore, a violation of Art. 221 of the Civil Code prohibiting contracts for "personal separation, between husband and wife" (and for every extrajudicial agreement for the dissolution of the conjugal partnership or of the absolute community of property between the husband and the wife).

LL and Company Development and Agro-Industrial
Corp. v. Huang Chao Chun and Yang Tung Fa
GR 142378, Mar. 7, 2002

FACTS: Petitioner argues that respondents should be ejected for non-payment of the new rental rates. That

is, the monthly rental is subject to increase. Said increase shall be based upon the imposition of Real Estate Tax for every two years upon presentation of the increased real estate tax to the lessees, but said increase shall not be less than 25%.

Respondents, upon the other hand, counter that they did not agree to these new rates. The former denied petitioner's allegations, claiming instead that their failure to pay the monthly rentals on the property was due to petitioner's fault when it attempted to increase the amount of rent in violation of their contract.

HELD: A unilateral increase in the rental rate cannot be authorized considering that: (1) the option to renew is reciprocal and, thus, the terms and conditions thereof — including the rental rate — must likewise be reciprocal; and (2) the contracted clause authorizing an increase — “upon presentation of the increased real estate tax to lessees” — has not been complied with, in the instant case, by petitioner.

A stipulation in a lease contract stating that it is subject to “an option to review” shall be interpreted to be reciprocal in character. Unless the language shows an intent to allow the lessee to exercise it unilaterally, such option shall be deemed to benefit *both* the lessor and the lessee who must *both* consent to the extension or renewal, as well as to its specific terms and conditions.

In the instant case, there was nothing in the aforesaid stipulation or in the actuation of parties that showed they intended an automatic renewal or extension of the term of the contract. Thus:

1. Demonstrating petitioner's disinterest in renewing the contract was its letter dated Aug. 23, 1996, demanding that respondents vacate the premises for failure to pay rentals since 1993. As a rule, the owner-lessor has the prerogative to terminate the lease upon its expiration. (*Vda. de Roxas v. CA*, 63 SCRA 302 [1975]).
2. In the present case, the disagreement of the parties over the increased rental rate and private respondents

failure to pay it, precluded the possibility of a mutual renewal.

3. The fact that the lessor allowed the lessee to introduce improvements on the property was indicative, not of the former's intention to extend the contract automatically (*Buce v. CA, 332 SCRA 151 [2000]*), but merely of its obedience to its express terms allowing the improvements. After all, at the expiration of the lease, those improvements were to "become its property."

As to the contention that it is not fair to eject respondents from the premises after only 5 years, considering the value of the improvements they introduced therein, suffice it to say that they did so with knowledge of the risk – the contract had plainly provided for a 5-year lease period.

Parties are free to enter into any contractual stipulation, provided it is not illegal or contrary to public morals. When such agreement, freely and voluntarily entered into, turn out to be disadvantageous to a party, courts cannot rescue it without crossing the constitutional right to contract. They are not authorized to extricate parties from the necessary consequences of their acts, and the fact that the contractual stipulations may turn out to be financially disadvantageous will not relieve the latter of their obligations. (*Torres v. CA, 320 SCRA 430 [1999]*).

(5) Limitations Imposed by Good Customs

Good customs are those that have received for a period of time practical and social confirmation. According to the Code Commission, good customs and morals "overlap each other; but sometimes they do not." (*Commission Report, p. 134*).

(6) Limitations Imposed by Public Order

- (a) Public order deals with the public *weal* (*Bough v. Cantiveros, 40 Phil. 209*), and includes public safety. (*Report of the Code Commission, p. 134*).

Villanueva v. Castañeda, Jr.
GR 61311, Sept. 21, 1987

Every contract affecting public interest suffers a congenital infirmity in that it contains an implied reservation of the police power as a postulate of the existing order. This power can be activated at any time to change the provisions of the contract, or even abrogate it entirely, for the promotion or protection of the general welfare. Such act will not militate against the impairment clause, which is subject to and limited by the paramount police power.

- (b) *Public order* as used in the old Civil Code was synonymous with public policy. (*Ferrazzini v. Gsell*, 34 Phil. 697).

(7) Limitations Imposed by Public Policy

- (a) Public policy, which varies according to the culture of a particular country, is the “public, social and legal interest in private law.” (*Ferrazzini v. Gsell*, 34 Phil. 697). It is said to be the manifest will of a State.
- (b) A contract is contrary to public policy if it “has a tendency to injure the public, is against the public good, or contravenes some established interest of society, or is inconsistent with sound policy and good morals, or tends clearly to undermine the security of individual’s rights.” (*Gabriel v. Monte de Piedad*, 71 Phil. 500).
- (c) Examples of agreements which are contrary to public policy:
- 1) those denying access to the courts. (*Manila Electric Co. v. Pasay Transportation*, 57 Phil. 603).
 - 2) those which tend to stifle the prosecution of a person charged with a *crime*, for a pecuniary or other valuable consideration. (*Arroyo v. Berwin*, 38 Phil. 386 and *Hibberd v. Rhode*, 32 Phil. 476).

(NOTE: In a few cases, a compromise is, however, permitted.)

- 3) those exempting a carrier from liability for gross negligence. (*Heacock v. Macondray*, 32 Phil. 205).
- 4) those which encourage fraud. (*Bough v. Cantiveros*, 40 Phil. 209).

- 5) those which authorize any attorney selected by the creditor to state before the court, should suit for collection be brought, that the debtor recognizes the existence and validity of the debt. (These are called “warrants of attorney to confess judgment.” These are void because they deprive the debtor of his day in court.) (*National Bank v. Manila Oil Refining Co.*, 43 Phil. 444).
- 6) those which constitute an *undue* or *unreasonable* restraint of trade, such as a prohibition to engage in *any* enterprise (whether similar or not with the enterprise of the employer) within a period of *five years* after leaving the service of the employer. (*Ferrazzini v. Gsell*, 34 Phil. 697). (If the restraint is reasonable, it should be given effect.) (*Ollendorf v. Abrahamson*, 38 Phil. 585 and *Red Line v. Bachrach Motor Co.*, 67 Phil. 577).
- 7) A stipulation allowing an agent or middleman 10% of a quota allocation in foreign exchange from the Central Bank (now *Bangko Sentral*). (*Tee v. Tacloban Electric and Ice Plant Co., et al.*, L-11980, Feb. 4, 1959; *Rep. Act 265 as amended, Sec. 3, Art. IV and a Central Bank [Bangko Sentral] Circular* which states that all applications for foreign exchange shall be made only thru authorized agent banks and states further that under no circumstances should any applicant, his agent and representative follow up an application with the Central Bank [Bangko Sentral].)
- 8) A stipulation bargaining away or surrendering for a consideration the right to vote and to run for public office. These are rights conferred *not* for individual or private benefit or advantages but for the public good and interest. (*Saura v. Sindico*, L-13403, Mar. 23, 1960).

Florentino B. del Rosario v. Eugenio Millado
Adm. Case 724, Jan. 31, 1969

If a lawyer in a case buys the subject matter involved in the litigation *during* said litigation, the purchase would

not be valid. However, if the purchase occurred *prior* to his entry into the case as counsel, the purchase must be regarded as a valid transaction.

Leal, et al. v. IAC
GR 65425, Nov. 5, 1987

FACTS: A contract entitled “*compraventa*,” written entirely in the Spanish language, provided that “*en caso de venta, no podran vender a otros dischos lotes de terreno sino al aqui vendedro o los herederos or sucesores de este x x x.*” This is an express prohibition against the sale of the lots described in the “*compraventa*” to third persons or strangers.

HELD: The provision is a nullity. A prohibition to alienate should not exceed at most a period of twenty years; otherwise, there would be subversion of public policy which naturally frowns on unwarranted restrictions on the right of ownership.

Top-Weld Manufacturing, Inc. v.
ECED, S.A., et al.
GR 44944, Aug. 9, 1985

The rule of *pari delicto* is expressed in the maxim “*ex dolo malo non oritor actio*” and “*in pari delicto potior est conditio defendentis.*” The law will not aid either party to an illegal agreement. It leaves the parties where it finds them.

Thus, a contract entered into by a domestic corporation with a foreign corporation to make and sell the latter’s products is illegal if the latter is not licensed to do business in the Philippines by the Board of Investments under Republic Act 5455. But if the domestic corporation is *in pari delicto*, it cannot ask our courts to stop the foreign corporation from terminating the contract and from negotiating with and transferring its license to produce and distribute its products to third persons.

(8) Examples of Stipulations Which Have Been Declared Valid

- (a) A stipulation limiting the liability of a guarantor or surety for only one year (or as long as it is for a longer time than the period fixed for the principal *debtor*). (*Jollye v. Barcelon and Luzon Surety Co.*, 50 O.G., p. 217; 68 Phil. 164).
- (b) A stipulation in a fire insurance policy that the action by the insured should be brought within a reasonable time. (*Macias & Co. v. China Fire Insurance Co.*, 46 Phil. 345).
- (c) A stipulation that interest on loans be compounded. (*Gov't. v. Vaca*, 64 Phil. 6).
- (d) A stipulation that an employee may be dismissed at any-time when his services are no longer needed; or that an employee may leave the services of the employer, without previous notice. (*Borrowsky v. Isako*, [C.A.] 40 O.G. 12th Supp., p. 264).
- (e) A stipulation to pay a debt, incurred during the Japanese occupation, in Philippine currency after liberation. (*De Leon v. Syjuco, Inc.*, 90 Phil. 311).
- (f) A stipulation in a contract of lease, allowing the tenant to retain the rents of the house for the payment of repairs and taxes. (*De los Reyes v. De los Reyes*, 8 Phil. 803).

(9) Designation of the Name of a Contract

- (a) The parties *generally* may agree on any contract, but the name that they give to it should not be controlling, for a contract is what the parties intended it to be, not what they call it. (*Quiroga v. Parsons Hardware Co.*, 38 Phil. 501).
- (b) This is because a contract must be judged by its character, its nature, and its legal qualifications. The courts will, therefore, look not so much at the form of the transaction as at its substance. (*Gabriel v. Monte de Piedad*, 71 Phil. 497).

(10) Insurance Contract

**UCPB General Insurance Co., Inc. v.
Masagana Telemart, Inc.
GR 137172, Apr. 4, 2002**

FACTS: Respondent, which had procured insurance coverage from petitioner for a number of years, had been granted a 60 to 90-day credit term for the renewal of policies. Such a practice had existed up to the time the claims were filed. Moreover, there was preponderant proof that no timely notice of non-renewal was made by petitioner.

ISSUE: Whether or not the fire insurance policies issued by petitioner to respondent covering the period from May 22, 1991 to May 22, 1992 had been extended or renewed by an implied credit arrangement though actual payment or premium was tendered on a later date and after the occurrence of the fire-risk insured against.

HELD: The insurer may grant credit extension for payment of premium. This simply means that if insurer has granted the insured a credit term for premium payment and loss occurs before expiration of term, recovery on the policy should be allowed even though premium is paid after the loss but within the credit term. There is nothing in Sec. 77 of the Insurance Code of 1978 which prohibits parties in an insurance contract to provide a credit term within which to pay the premiums. That agreement is not against the law, morals, good customs, public order, or public policy. The agreement binds the parties. (*See Art. 1306, Civil Code*).

In the instant case, it would be unjust and inequitable if recovery on the policy would not be permitted against petitioner, which had consistently granted a 60 to 90-day credit term for payment of premium despite its full awareness of Sec. 77 aforementioned above. Estoppel tears it from taking refuge under said section, since respondent relied in good faith on such practice.

Art. 1307. Innominate contracts shall be regulated by the stipulations of the parties, by the provisions of Titles I and II of this Book, by the rules governing the most analogous nominate contracts, and by the customs of the place.

COMMENT:**(1) Governing Rules for Innominate Contracts**

- (a) stipulations
- (b) Titles I and II of Book IV — Obligations and Contracts
- (c) rules on the most ANALOGOUS nominate contracts
- (d) customs of the place

(2) The 4 Kinds of Innominate Contracts

- (a) *do ut des* (I *give* that you may *give*)
- (b) *do ut facias* (I *give* that you may *do*)
- (c) *facio ut des* (I *do* that you may *give*)

San Miguel Corp. v. NLRC
GR 80774, May 31, 1988

The innovation program sponsored by a corporation inviting its employees to submit innovation proposals and the corporation undertaking to grant cash awards to employees who accept such invitation and whose innovative suggestions, in the judgment of the corporation's officials, satisfied the standards and requirements of the program and which, therefore, could be translated into some substantial benefit to the corporation, though a unilateral undertaking in origin, could nonetheless ripen into an enforceable (*facio ut des*) obligation on the part of the corporation under certain circumstance.

- (d) *facio ut facias* (I *do* that you may *do*)

Santos v. Acuña
53 O.G. No. 385

FACTS: In a contract, the provisions of which were very similar to a lease contract, both parties *agreed* that the same SHOULD NOT be regarded as a lease. **Issue:** Is this stipulation valid?

HELD: Yes, because:

- (1) there is no legal provision prohibiting such a stipulation (generally, whatever is agreed upon is *binding*, particularly in a *consensual* contract such as LEASE)
- (2) this agreement may be considered one of the *innominate contracts* expressly allowed under Art. 1307.

(3) Legal Services for a Friend

Corpus v. Court of Appeals 98 SCRA 424

If an attorney renders legal services for a close friend, the former can still charge attorney's fees even in the absence of any agreement thereon. This is because of the innominate contract of *facio ut des* (I do that you may give) which, in turn, is based on the principle that one cannot unjustly enrich himself at another's expense.

Art. 1308. The contract must bind both contracting parties; its validity or compliance cannot be left to the will of one of them.

COMMENT:

(1) Mutuality of Contracts

This Article stresses the *mutuality of contracts* — that is, both parties are bound. The principle is based on the essential *equality* of the parties. It is repugnant to *bind* one party, and yet leave the other *free*. (*Garcia v. Rita Legarda, Inc.*, L-20175, Oct. 30, 1967).

Alcuaz v. PSBA, et al. GR 76353, May 2, 1988

FACTS: For taking part in a demonstration or protest which the school authorities branded as “anarchic” rallies, certain students were barred from re-enrollment while some teachers were dismissed. The affected students and teachers alleged that they have been deprived of procedural due process which

requires that there be due notice and hearing, and of substantive due process which requires that the person or body to conduct the investigation be competent to act and decide, free from bias and prejudice. It is not disputed that Printed Rules and Regulations of the school are distributed at the beginning of each school year to the students. The Rules, among others, provide: "Enrollment in the PSBA is contractual in nature and upon admission to the school, the student is deemed to have agreed to bind himself to all rules and regulations by the Department of Education, Culture and Sports. Furthermore, he agrees that he may be required to withdraw from the school at any time for reasons deemed sufficiently serious by the School Administration."

HELD: Paragraph 137 of the Manual of Regulations for Private Schools provides that when a college student registers in a school, it is understood that he is enrolling for the entire semester. The Manual also provides that the "written contract" required for college teachers are for "one semester." It is beyond dispute that a student once admitted to school is considered enrolled for one semester. Evidently, after the close of the semester the school has no longer any existing contract either with the students or with the intervening teachers. Such being the case, the charge of denial of due process is untenable. For contracts are respected as the law between the contracting parties. And the courts, be they the original trial court or the appellate court, have no power to make contracts for the parties.

(2) Consequences of MUTUALITY

- (a) *A party cannot revoke or renounce a contract without the consent of the other, nor can it have it set aside on the ground that he had made a bad bargain. (Fernandez v. MRR, 14 Phil. 274).*
- (b) When the fulfillment of the condition depends upon the sole will of the debtor, the conditional obligation is void (*Art. 1182, Civil Code*) if the condition is **SUSPENSIVE**. If **RESOLUTORY**, the obligation is valid. Hence, it is all right for the contract to expressly give to one party the right to **CANCEL** the same. This is because, when the contract is thus cancelled, the agreement is really being **FULFILLED**. (*Taylor v. Uy Tieng Piao and Tan Liuan, 43 Phil. 873*).

(*NOTE*: When a cancellation is made, BOTH parties must of course be released.)

Melencio v. Dy Tiao
5 Phil. 99

FACTS: Two persons entered into a contract of lease of land. It was stipulated that at any time *before* the tenant constructed any building thereon, he could *cancel* the lease. *Issue*: Is the stipulation valid?

HELD: Yes, for here again, when cancellation is made, this by itself is a *fulfillment* of the provisions of the contract.

PNB v. CA
GR 88880, Apr. 30, 1991

FACTS: The Philippine National Bank (PNB) over the objection of debtor, and without authority from the Monetary Board, within a period of only four months, increased the 18% interest rate on the borrower's loan obligation three times: (a) to 32% in Jul. 1984; (b) to 41% in Oct. 1984; and (c) to 48% in Nov. 1984.

HELD: Those increases were null and void, for if the Monetary Board itself was not authorized to make such changes oftener than once a year, even less so may a bank, which is subordinate to the Board. While the debtor did agree in the Deed of Real Estate Mortgage that the interest rate may be increased during the life of the contract "to such increase within the rate allowed by law, as the Board of Directors of the Mortgagee may prescribe" or "within the limits allowed by law," no law was ever passed in Jul. to Nov. 1984 increasing the interest rates on loans or renewals thereof to 32%, 41% and 48% (*per annum*), and no documents were executed and delivered by the debtor to effectuate the increase. Central Bank Circular 905, Series of 1982 removed the Usury Law ceiling on interest rates, but it did not authorize the PNB, or any bank for that matter, to unilaterally and successively increase the agreed

rate of interest rates from 18% to 48% within a span of four (4) months, in violation of Presidential Decree 116 which limits such changes to “once every twelve months.”

Besides, violating PD 116, the unilateral action of the PNB in increasing the interest rate on the borrower’s loan violated the mutuality of contracts ordained in Art. 1308 of the Civil Code. In order that obligations arising from contracts may have the force of law between the parties, there must be mutuality between the parties based on their essential quality. A contract containing a condition which makes its fulfillment dependent exclusively upon the uncontrolled will of one of the contracting parties is void. And even assuming that the P1.8 million loan agreement between the PNB and the borrower gave the PNB a license (although in fact there was none) to increase the interest rate at will during the term of the loan, that license would have been null and void for being violative of the principle of mutuality essential on contracts. It would have invested the loan agreement with the character of a contract of adhesion, where the parties do not bargain on equal footing, the weaker party’s (the debtor’s) participation being reduced to the alternative “take it or leave it.” Such a contract is a trap for the weaker party whom the courts of justice must protect against abuse and imposition. PNB’s successive increase of the interest rate on the borrower’s loan, over the latter’s protest, were arbitrary as they violated an express provision of the Credit Agreement, Sec. 9.01, that its terms “may be amended only by an instrument in writing signed by the party to be bound as burdened by such amendment.” The increases imposed by the PNB also contravene Art. 1956 of the Civil Code which provides that “no interest shall be due unless it has been expressly stipulated in writing.” Here, the debtor never agreed in writing to pay the interest increases fixed by the PNB beyond the 24% per annum; hence, he is not bound to pay a higher rate than that. The increase in the interest rate from 18% to 48% within a period of four (4) months is excessive.

(NOTE: In *Banco Filipino Savings and Mortgage Bank v. Navarro*, 15 SCRA 346 [1987], the Supreme Court

disauthorized the bank from raising the interest rate on the borrower's loan from 12% to 17% despite an escalation clause in the loan agreement signed by the debtors authorizing Banco Filipino "to correspondingly increase the interest rate stipulated in this contract without advance notice to me/us in the event a law should be enacted increasing the lawful rates of interest that may be charged on this particular kind of loan." The bank relied on Section 3 of Central Bank (Bangko Sentral) Circular 494, dated Jul. 1, 1976 (72 O.G. No. 3, p. 676-J) which provided that "the maximum rate of interest, including commissions, premiums, fees and other charges on loans with a maturity of more than 730 days by banking institutions shall be 19%." The Court disallowed the increase because "Circular 494, although it has the effect of law is not a law." The Court held: "From Mar. 17, 1980, escalation clauses, to be valid, should specifically provide: (1) that there can be an increase in interest if increased by law or by the Monetary Board; and (2) in order for such stipulation to be valid, it must include the provision for reduction of the stipulated interest "in the event that the applicable maximum rate of interest is reduced by law or by the Monetary Board." In the present case, the PNB relied on its own board resolution and circulars but those resolution and circulars are neither laws nor resolutions of the Monetary Board.)

(3) Exception to Inviolability of Contractual Obligations

Anucension v. National Labor Union 80 SCRA 350

The rule that the obligation of contracts should not be impaired is not absolute. Thus, the free exercise of religious beliefs is superior to contractual rights. An example is the belief of a religious sect that its members should not join a labor organization or participate in a collective bargaining agreement.

Art. 1309. The determination of the performance may be left to a third person, whose decision shall not be binding until it has been made known to both contracting parties.

COMMENT:**(1) Determination by Third Person**

Example: In a contract of sale, the fixing of the *price* and the *delivery* date can be left to a third person.

(2) When Decision Is Binding

The decision binds the parties only after it is *made known to both*.

(3) Effect of Stipulation Regarding Arbitration

If in a contract, there is a stipulation for arbitration (under Rep. Act 875), and one party, in case of dispute, refuses to submit the matter to arbitration, the aggrieved party who goes to court to request it to order the other party to submit the matter to arbitration, should NOT anymore present to the court the merits of the disputed matters. The decision on said merits will be up to the arbitrator. The only function of the Court in this case would be to decide whether or not the parties should proceed to arbitration. (*Maguindanao Portland Cement Corp. v. McDonough*, GR 23390, Apr. 24, 1967).

Art. 1310. The determination shall not be obligatory if it is evidently inequitable. In such case, the courts shall decide what is equitable under the circumstances.

COMMENT:**Evidently Inequitable Determination Is Not Binding**

- (a) What is equitable is a question of fact, to be ascertained from the attendant circumstances.
- (b) The court is called upon to decide what is equitable.

Art. 1311. Contracts take effect only between the parties, their assigns and heirs, except in case where the rights and obligations arising from the contract are not transmissible by their nature, or by stipulation or by provision of law. The heir is not liable beyond the value of the property he received from the decedent.

If a contract should contain some stipulation in favor of a third person, he may demand its fulfillment provided he communicated his acceptance to the obligor before its revocation. A mere incidental benefit or interest of a person is not sufficient. The contracting parties must have clearly and deliberately conferred a favor upon a third person.

COMMENT:

(1) Principle of Relativity

This Article stresses the principle of RELATIVITY — that is, contracts are generally effective only between the PARTIES, their ASSIGNS, and their HEIRS.

**Quano v. CA, et al.
GR 95900, Jul. 23, 1992**

It is a basic principle in civil law that, with certain exceptions not obtaining in this case, a contract can only bind the parties who had entered into it or their successors who assumed their personalities or their juridical positions, and that, as a consequence, such contract can neither favor nor prejudice a third person.

The obligation of contracts is limited to the parties making them and, ordinarily, only those who are parties to contracts are liable for their breach. Parties to a contract cannot thereby impose any liability on one who, under its terms, is a stranger to the contract, and, in any event, in order to bind a third person contractually, an expression of assent by such person is necessary.

**FGU Insurance Corp. v. G.P. Sarmiento Trucking
Corp. & Lambert M. Eroles
GR 141910, Aug. 6, 2002**

FACTS: A truck driver was not a party to the contract of carriage between petitioner's principal and defendant. *Issue:* May he be held liable under the agreement?

HELD: No, he may not be held liable. Respondent driver, without concrete proof of his negligence or fault, may not himself

be ordered to pay petitioner. For a contract can only bind the parties who have entered into it or their successors who have assumed their personality or their juridical position. Consonantly with the action *res inter alios acta aus neque nocet prodest*, such contract can neither favor nor prejudice a third person.

Petitioner's civil action against the driver can only be based on *culpa aquiliana*, which, unlike *culpa contractual*, would require the claimant for damages to prove negligence or fault on the part of the defendant. (*Calalas v. CA*, 332 SCRA 356). (See Art. 2176, Civil Code).

Siredy Enterprises, Inc. v. CA
Conrado de Guzman
GR 129039, Sept. 17, 2002

FACTS: Private respondent Conrado de Guzman is an architect-contractor doing business under the name and style of Jigscon Construction. Herein petitioner Siredy Enterprises, Inc. (SEI) is the owner and developer of Ysmael Village, a subdivision in Sta. Cruz, Marilao in Bulacan. The president of SEI is Ismael E. Yanga. As stated in its Articles of Incorporation, the primary corporate purpose of SEI is to acquire lands, subdivide and develop them, erect buildings and houses thereon, and sell, lease or otherwise dispose of said properties to interested buyers.

Sometime before Oct. 1978, Yanga executed an undated letter of Authority (LoA) authorizing Hermogenes B. Santos to do and execute certain acts in representation of SEI. Thus, on Oct. 15, 1978, Santos entered into a Deed of Agreement with de Guzman. The deed expressly stated that Santos was "representing SEI." Private respondent was referred to as "contractor" while petitioner SEI was cited as "principal." From Oct. 1978 to Apr. 1990, de Guzman constructed 26 residential units at Ysmael Village. Thirteen of these were fully paid but the other 13 remained unpaid. The total contractual price of these 13 unpaid houses is P412,154.93 which was verified and confirmed to be correct by Santos, per an accomplishment Billing that the latter signed. De Guzman tried but failed to collect the unpaid account from petitioner. Thus, he instituted the action in the

RTC of Malolos, Bulacan for specific performance against SEI, Yanga, and Santos who all denied liability. During the trial, Santos disappeared and his whereabouts remain unknown.

In its defense, petitioner presented testimonial evidence *to the effect that SEI had no contract with De Guzman* and had not authorized Santos to enter into a contract with anyone for the construction of housing units at Ysmael Village. The trial court agreed with petitioner based on the doctrine of *privity of contract*. On appeal, de Guzman obtained a favorable judgment from the Court of Appeals (CA). The CA held that the LoA duly signed by Yanga clearly constituted Santos as SEI's agent, whose authority included entering into a contract for the building of housing units at Ysmael Village. Consequently, SEI cannot deny liability for the Deed of Agreement with private respondent de Guzman, since the same contract was entered into by SEI's duly designated agent, Santos. There was no need for Yanga himself to be a signatory to the contract, for him and SEI to be bound by the terms thereof. Hence, the CA in reversing the appealed decision rendered the following verdict: Appellee SEI is ordered to pay appellant de Guzman's costs and P412,154.93 as actual damages plus legal interest thereon from the filing of the complaint on Jul. 29, 1982 until full payment thereof. All other claims and counterclaims are dismissed. Hence, this petition for review on *certiorari* under Rule 45 of the Rules of Court.

Issues: (1) Whether or not Santos was a duly-constituted agent of SEI, with authority to enter into contracts for the construction of residential units in Ysmael Village and, thus, the capacity to bind SEI to the Deed of Agreement; and (2) Assuming *arguendo* that SEI was bound by the acts of Santos, whether or not under the terms of the Deed of Agreement, SEI can be held liable for the amount sought to be collected by private respondent de Guzman.

HELD: (1) A valid agency was created between SEI and Santos, and the authority conferred upon the latter includes the power to enter into a construction contract to build houses such as the Deed of Agreement between Santos and de Guzman's Jigscon Construction. Hence, the inescapable conclusion is that SEI is bound by the contract thru the representation of its agent Santos.

(2) This matter is being raised for the first time on appeal. From the trial in the RTC to the appeal before the CA, the alleged violation of the Deed of Agreement by de Guzman was never put in issue. Heretofore, the substance of petitioner's defense before the courts *a quo* consisted of its denial of any liability under the Deed of Agreement. Thus, "a question that was never raised in the courts below cannot be allowed to be raised for the first time on appeal without offending basic rules of fair play, justice, and due process. Such an issue was not brought to the fore either in the trial court or the CA, and would have been disregarded by the latter tribunal for the reasons previously stated. With more reason, the same does not deserve consideration by this Court. (*Safic Alcan & Cie v. Imperial Vegetable Oil Co., Inc.*, 355 SCRA 559 [2001]).

Petitioner SEI is ordered to pay de Guzman actual damages in the amount of P412,154.93, with legal interest thereon from the time the case was filed until its full payment.

(2) Exceptions to the Principle of Relativity

- (a) Where the obligations arising from the contract are not transmissible by their NATURE, by STIPULATION, or by PROVISION OF LAW. (*Art. 1311, Civil Code*).
- (b) Where there is a *STIPULATION POUR AUTRUI* (a stipulation in favor of a third party). (*Art. 1311, Civil Code*).
- (c) Where a third person induces another to violate his contract. (*Art. 1314, Civil Code*).
- (d) Where, in some cases, third persons may be adversely affected by a contract where they did not participate. (*See Arts. 1312, 2150, 2151, Civil Code; Act 1956, the Insolvency Law; and Rep. Act 875*).
- (e) Where the law authorizes the creditor to sue on a contract entered into by his debtor ("*Accion Directa*").

(3) Discussion of the General Rule

- (a) "Contracts take effect only between the parties, their assigns, and heirs" (*Art. 1311, Civil Code*), and, therefore, generally, its terms cannot determine the rights of third

persons. (*Bautista, et al. v. Judge Piguing*, L-10006, Oct. 31, 1957; *Phil. Nat. Bank v. Luzon Surety Co., Inc.*, L-1112, May 28, 1958; and *Nat. Labor Union v. Int. Oil Factory*, L-13845, May 30, 1960). The revocation, for example, of a deed of sale is not conclusive on those individuals who are not parties thereto. (*Real Monasterio de la Purisima Concepcion v. Domingo Fabian, et al.*, L-28470, Sept. 19, 1968). However, a person who takes advantage of a contract, although he is *NOT* a signatory thereto, can properly be bound by the terms thereof. He cannot take advantage of a contract when it suits him to do so, and reject its provision when he thinks otherwise. (*Northern Motors, Inc. v. Prince Line*, L-13884, Feb. 29, 1960 and *Cenon Villanueva v. Barber-Wilhelmsen Line, et al.*, L-14764, Nov. 23, 1960).

(b) *Reasons for the rule:*

“Res inter alios acta aliis neque nocet prodest.” (The act, declaration, or omission of another, cannot affect another, except as otherwise provided by law or agreement.) (*See Sec. 25, Rule 130, Revised Rules of Court*).

Example: If I promised to buy Mr. X's land, and Mr. X promised to sell to me the same, my friend Y cannot insist that the contract be performed.

El Hogar Filipino v. Angeles
L-11613, Sept. 30, 1958

FACTS: A was a stockholder in a mutual building and loan association. Her shares matured in 1940, and from that time, she ceased to be a stockholder, and instead became its creditor for the value of her shares. At this point, the officers and members of the Board of Directors entered into an agreement with the Central Bank concerning the revaluation of the shares. *Issue:* Is A bound by the act of the Corporation (Association)?

HELD: No, because at the time of agreement, she was no longer a stockholder and, therefore, the officers and the Board of Directors had lost their power to represent and bind her in corporate transactions. The agreement does not bind her unless she ratifies the agreement expressly or impliedly.

(NOTE: In this case, it is clear that being a stranger to the contract, she was not bound by it.)

(NOTE: A deed of assignment of property not registered does not and cannot prejudice or favor strangers to the agreement.)

Bobis v. Provincial Sheriff of Camarines Norte
GR 29838, Mar. 18, 1983

A writ of execution which seeks to enforce a judgment based on compromise cannot be enforced against a person who is not a party to said compromise (although) he may have been a party to the action.

- (c) Strangers, therefore, *cannot generally* demand the enforcement of a contract (*Manila Railroad Co. v. Compania Transatlantica*, 38 Phil. 875); nor can they demand its annulment (*Ayson v. Court of Appeals*, GR L-6501 and 6500; May 21, 1955); nor are they bound by the same. (*Celis v. Benedicto*, O.G. March 6, 1941, p. 652 and 8 Manresa 630-631).

Manila Railroad Co. v. Compania Transatlantica
38 Phil. 875

FACTS: A shipped his cargo in B's vessel. B and C's company entered into a contract for C's company to *unload* the cargo from the ship's hold. In the lifting operations, A's cargo was damaged. **Issue:** May A successfully sue C's company for damages?

HELD: No, for there was no contract between A and C's company. A's remedy is to go against B.

Celis v. Benedicto
O.G. March 6, 1941, p. 652

FACTS: A leased his property to B. B subleased part of the premises to C. B violated the conditions of the lease, so A wanted to rescind the lease contract. C objected because if the lease is cancelled, the sublease would naturally be affected. **Issue:** Will C's objection prosper?

HELD: No, because A is not *bound* by the sublease, inasmuch as he did not participate therein.

**House International Building Tenants
Association, Inc. v. IAC
GR 75287, Jun. 30, 1987**

FACTS: To secure payment of his obligation to the GSIS, FA mortgaged a parcel of land and a 14-storey building on said land. After the GSIS foreclosed the mortgage and after it had consolidated ownership in its name [*i.e.*, after FA failed to redeem the property], the GSIS sold the property to CENTERTOWN under a deed of conditional sale, without notice to the tenants of the building and without securing prior clearance of the Ministry of Human Settlements. Because CENTERTOWN is not authorized to engage in real estate business, it organized a sister corporation, TOWERS, to engage in real estate business. Later, CENTERTOWN assigned to TOWERS all its rights and obligations under the Deed of Conditional Sale, with the consent and approval of the GSIS.

The association of tenants of the building sued CENTERTOWN, TOWERS, and GSIS for annulment of the deed of conditional sale and the subsequent assignment of the sale by CENTERTOWN to TOWERS, on the ground that the sale is VOID *ab initio* because it is *ultra vires*, since CENTERTOWN is not qualified to acquire real estate or engage in real estate transactions, and also because “its consideration is illicit” pursuant to Art. 1409.

HELD: The Tenant’s Association is neither a party nor a privy to the Deed of Conditional Sale and the assignment thereof. Hence, it cannot assail the validity of said contracts. The interest one has in a given contract determines the right of a party obligated principally or subsidiarily to enable him to bring an action to nullify the contract in which he intervenes. He who has no right in a contract is not entitled to prosecute an action for nullity. The person who is not a party to a contract or has no cause of action or representation from those who intervened therein has no right of action and personality so as to enable him to assail the validity of the contract.

The main thrust of the Association's challenge on the validity of the conditional sale is that the contract is *ultra vires* because CENTERTOWN is not qualified to acquire properties under its articles of incorporation. The Association has confused a void contract with an *ultra vires* contract which is merely voidable.

Cited to support its assertion that the conditional sale is against public policy are the provisions of the 1973 Constitution on eminent domain (*Art. IV, Sec. 2; Art. XIV, Sec. 3*), agrarian reform (*Art. XIV, Sec. 12*) and the Declaration of Principles and State Policies, particularly those emphasizing the "stewardship concept, under which property is supposed to be held by the individual only as trustee for the people in general, who are its real owners." (*Art. II, Secs. 6 and 7*). These constitutional provisions are inapposite as bases for a declaration that the conditional sale is null and void. Not one of these provisions render unlawful the contract in question. Except for the prohibition against the taking of a private property for public use without just compensation, the other provisions require implementing legislation to confer a legal right and impose a legal duty which can be judicially invoked.

(d) *Problem*

S sold and delivered his property to *B* on credit. It was agreed that *B* should not sell the property to another, 'til after the price had been paid in full to *S*. Subsequently, *B* sold the property to *X* although *B* has not yet paid fully the price. May the sale of *X* be cancelled on this ground?

ANS.: No, because *X* was not a party to the agreement between *S* and *B*. *S* may, however, sue *B* for damages. (*See TS, Oct. 15, 1897 and 8 Manresa 630-631*).

**New Manila Lumber v. Republic
of the Philippines
L-14248, Apr. 28, 1960**

FACTS: A lumber company sued the government for the payment of certain materials obtained from it by a contractor in connection with the construction of two

public school buildings. Incidentally, the government had already a pending suit against said contractor for breach of contract. *Issue*: Will the suit of the lumber company prosper?

HELD: No, because the lumber company is *not* a party to the contract between the government and the contractor. Its remedy is *to intervene* in the case between the government and the contractor, *or to file* an action in the name of the Republic against the contractor on the latter's bond. If at all a claim is to be made against the Republic, the same should have been lodged with the Auditor General. Indeed, the State cannot be sued without its consent.

GSIS v. Susana Romualdo, et al.
L-26170, Jan. 27, 1969

Intestate heirs who did *not* sign the deed of extra-judicial settlement (giving to one particular individual the entire property) *cannot* be bound by said agreement — in the absence of evidence that said non-signatory heirs had given subsequently their conformity thereto.

- (e) Heirs are bound to respect the contracts entered into by their predecessors in interest (*Art. 1311, Civil Code*) in view of their PRIVACY OF INTEREST with such predecessor. (*Galsinao v. Austria, GR L-7918, May 25, 1955*). Therefore, if the predecessor was duty-bound to reconvey land to another, and at his death the reconveyance had *not* yet been made, the heirs can be compelled to execute the proper deed for reconveyance. (*De Guzman v. Salak, GR L-4133, May 13, 1952*). The heirs, however, are not liable beyond the value of the property they received from the decedent. (*Art. 1311, Civil Code*).
- (f) In order that an heir can question the validity of contracts entered into by his predecessor, or bring an action to *annul* the same, he must be a *compulsory or forced heir*, for the simple reason that the deceased could do with the property whatever he desired, as long as he respects the rights of his *compulsory or forced heirs*. (*Velarde, et al. v. Paez, et al., L-9208-9216, Apr. 30, 1957*).

**Velarde, et al. v. Paez, et al.
L-9208-9216, Apr. 30, 1957**

FACTS: The deceased was the registered owner of several parcels of land which were sold to the defendants. The deceased left no compulsory heirs. The only intestate heirs were the plaintiffs, who were the *nephew* and *niece* of the deceased. The plaintiffs alleged that the sales were *not* valid because the deceased had been made to sign the sale documents thru the fraud, deceit, and misrepresentation of the defendants. **Issue:** Did the plaintiffs have the legal capacity to question the validity of the deeds of sale?

HELD: No, because they are not *compulsory heirs*. Moreover, they were neither principally nor subsidiarily bound by the contracts of sale. In the instant case, the decedent could dispose of her estate without any limitations except those imposed by law. It cannot be said that their legitimes were impaired, for they are *not* compulsory heirs, and are, therefore, *not* entitled to any legitime.

- (g) **Question:** May compulsory heirs question the deceased's transactions?

ANS.:

- 1) if they were voidable — YES. (*Velarde v. Paez, supra*).
- 2) if they were *illicit* or *illegal* — NO, because even the deceased had no right to question them herself, and had no right to recover the properties *illicitly conveyed*. **HOWEVER**, an action to **RESCIND** the contract can prosper, *insofar as the legitimes of the compulsory heirs are prejudiced*, under Art. 1381(3) of the Civil Code (which refers to the right of creditors to *rescind* contracts in fraud of their rights), because the *right to the legitime is similar to a credit of a creditor*, insofar as the right to the *legitime* may be defeated by such transaction. (*Concepcion v. Sta. Ana, L-2277, Dec. 29, 1950*).

(NOTE: In the *Velarde v. Paez* case, neither the remedy of *annulment* nor of *rescission* could be availed

of for the simple reason that the heirs in said case were not compulsory heirs.)

- (h) Rights of the predecessor may be transmitted to the heirs provided they are *not intransmissible*.
 - 1) The heirs of the beneficiary of a trust may enforce the trust as against the trustee. (*Cristobal v. Gomez*, 50 Phil. 810).
 - 2) The heirs may continue a lease contract entered into by the deceased. (*Eleizegui v. Manila Lawn Tennis Club*, 2 Phil. 309).

(4) The First Exception — when the obligation arising from the contract are not transmissible by their *nature*, by *stipulation*, or by *provisions of law*.

- (a) *Examples*: a contract of partnership, or a contract of agency (Here *death of a partner*, of the principal, or of the agents ENDS the contract, and the heir does *not* step into the shoes of the deceased.)
- (b) Money debts are not directly chargeable against the heirs. They should be claimed in the estate or intestate proceedings for the settlement of the estate of the deceased. (*See Velayo v. Patricio*, 50 Phil. 178).

(5) The Second Exception — Stipulation Pour Autrui

- (a) *Codal Provision* — “If a contract should contain *some stipulation in favor of a third party*, he may demand its fulfillment provided he *communicated his acceptance to the obligor before its revocation* (the revocation of the whole contract itself or of the stipulation alone). The contracting parties must have *clearly and deliberately conferred a favor upon a third person. A mere incidental benefit or interest of a person is not sufficient.*” (Art. 1311, second paragraph).
- (b) *Requisites*:
 - 1) There must be a stipulation in *favor of a third person*.
 - 2) The contracting parties must have *clearly and deliberately conferred a favor upon a third person*.

- 3) A mere incidental benefit or interest of a person is NOT sufficient. (*See Uy Tam v. Leonard, 30 Phil. 471*).
 - 4) The stipulation must be PART of the contract.
 - 5) The third person communicated his *acceptance* to the obligor *before its revocation* (revocation of the contract or the stipulation by the *original parties*) (*See Kauffman v. Phil. Nat. Bank, 42 Phil. 182*); acceptance may be in the form of a DEMAND. (*Ibid.*).
 - 6) There must be no relation of agency between either of the parties and the third person. (*8 Manresa 632*).
- (c) *Definition of a Stipulation Pour Autrui:*

It is a stipulation in favor of a third person conferring a clear and deliberate favor upon him, and which stipulation is merely part of a contract entered into by the parties, neither of whom acted as agent of the third person.

**Rebecca C. Young, et al. v. CA, et al.
GR 79518, Jan. 13, 1989**

The requisites of a stipulation *pour autrui* or a stipulation in favor of a third person are the following:

- (1) There must be a stipulation in favor of a third person.
- (2) The stipulation must be a part, not the whole, of the contract.
- (3) The contracting parties must have clearly and deliberately conferred a favor upon a third person, not a mere incidental benefit or interest.
- (4) The third person must have communicated his acceptance to the obligor before its revocation.
- (5) Neither of the contracting parties bears the legal representation or authorization of the third party.

[NOTE: Such a stipulation is *binding* on said third person, although he may *not* be a signatory to the contract. (*Northern Motors, Inc. v. Prince Line, et al., L-13884, Feb. 29, 1960*).]

**Associated Bank v. CA & Lorenzo Sarmiento, Jr.
GR 123793, Jun. 29, 1998**

The “fairest test” in determining whether the third person’s interest in a contract is a stipulation *pour autrui* or merely an incidental interest is to examine the intention of the parties as disclosed by their contract.

- (d) *Example: D* purchased *C*’s land for P10,000,000. It was also agreed that only P8,000,000 would be given to *C*, because the remaining P2,000,000 would be given by *D* to *X*, a creditor of *C*. If *X* communicates his acceptance of the stipulation to *D*, *X* can demand its fulfillment.
- (e) *Another example* — Insurance taken by a taxi company in favor of its passengers.
- (f) *Cases*

**Florentino v. Encarnacion, Sr.
79 SCRA 195**

A stipulation in a contract stating that the fruits of a certain parcel of land will be used for expenses connected with specified religious festivities is a clear example of a stipulation *pour autrui*.

**Melecio Coquia, et al. v. Fieldmen’s Ins. Co., Inc.
L-23276, Nov. 29, 1968**

FACTS: The Manila Yellow Taxicab Co. obtained a common carrier accident insurance policy from the Fieldmen’s Insurance Co. Under the terms of the policy, the Insurance agreed to indemnify any *fare-paying passenger, including the authorized driver*, driving the taxi at the time of the accident. In the event of death, the personal representatives would be given the indemnity. The contract likewise provides that before suit could be brought, the matter will first be decided by arbitrators.

Now then, while the policy was in force (Feb. 10, 1962) a taxi of the Insured, driven by duly-authorized driver, Carlito Coquia, met an accident where Carlito died. Although neither party sought to have the matter settled by

arbitrators, Coquia's heirs sought indemnity in a judicial action against the Insurance Company. The latter alleges that:

- 1) the heirs have no contractual relations with the company;
- 2) the Insured has not complied with the contractual provisions on arbitration.

HELD: The heirs can recover indemnity from the Insurance Company because of the following reasons:

- 1) While in general only parties to a contract can sue on an action based thereon, one exception is in the case of a *stipulation pour autrui*. In this insurance case, there clearly is a benefit conferred directly in favor of the passengers and the *authorized driver* (or their heirs). Hence, the heirs can sue. (*See Uy Tan v. Leonard*, 30 Phil. 471 and *Kauffman v. Philippine National Bank*, 42 Phil. 182). The heirs indeed have a proper cause of action, *even without* joining the insured Taxi Co. (*See Guingon v. Capital Insurance & Surety Co.*, L-22042, Aug. 17, 1967).
- 2) Since neither party during the negotiations preceding the institution of the case invoked the reference to arbitration, this omission has the effect of a WAIVER of their respective rights to demand an arbitration. (*See Independent School District, No. 35, St. Louis County v. A. Hedenberg and Co.*, 7 NW 2nd, 511, 517, 518).

Kauffman v. Phil. Nat. Bank
42 Phil. 182

FACTS: The Philippine Fiber and Produce Company, for some consideration, contracted with the Philippine Nat. Bank. One of the stipulations was for the bank to order its representative in New York to give a certain sum of money to Mr. Kauffman, who was President of the Phil. Fiber and Produce Company. After the order was given, the New York representative suggested that the money be *withheld* from Mr. Kauffman in view of the latter's *reluctance* to pay for

some company debts. The Manila office then told the New York representative to WITHHOLD said money. Later, Mr. Kauffman demanded payment, and when this was refused, he instituted this action. *Issue*: Is Kauffman entitled to the amount?

HELD: Yes, because this is a clear case of a stipulation *pour autrui*. The demand for payment constituted an acceptance of the stipulation. It cannot be said that there had been a PRIOR revocation of the stipulation, for while it is true that the Bank had ordered its New York representative to withhold payment, still the revocation referred to in the law is a revocation by BOTH parties to the original contract.

**Vargas Plow Factory, Inc.
v. The Central Bank of the Phil.
L-25732, Feb. 27, 1969**

A stipulation in a contract whereby a *letter of credit* is opened in favor of a third party is a stipulation *pour autrui*.

**Florentino v. Encarnacion, Sr.
79 SCRA 196**

A stipulation *pour autrui* need not be in any particular form, and may even be inferred from the fact that the beneficiary has enjoyed the same for a considerable period.

**Northern Motors, Inc. v. Prince Line, et al.
L-13884, Feb. 29, 1960**

FACTS: The Delgado Brothers, Inc. was the arrastre contractor for Manila in charge of unloading and delivering cargo. In its contract with the Bureau of Customs, it *generally* limited its liability to P500 for each package lost. *Issue*: If a consignee (3rd person) takes advantage of this service, is it bound by the limited liability?

HELD: Yes, because of its “acceptance.”

Cronico v. J.M. Tuason & Co., Inc.
L-35272, Aug. 26, 1977

A stipulation *pour autrui* is for the benefit of somebody who is not a party to a contract. If the stipulation states that one of the parties to a contract is exempt from all previous claims and damages sustained by the other party, the stipulation is *not pour autrui*.

- (g) If the stipulation be *merely incidental*, it is *not* the stipulation *pour autrui* referred to in the law. An example of such incidental stipulation occurs when a surety company executes a bond in favor of the City of Manila to guarantee a construction company's *building* transaction, and states incidentally in the bond that it shall promptly make all *payments to labor and materialmen*. Here, the labor and materialmen cannot sue on the basis of the bond, even if they had previously made known their acceptance of such stipulation. (*Uy Tam v. Leonard*, 30 Phil. 471). (Here, the Court said that from the language of the bond, it was clear that the creditor was the City of Manila, and that it was never intended by the surety company that it would be bound to the labor and materialmen in case of non-payment to them.)
- (h) The acceptance of the stipulation by the third party may be made *expressly* or *implicitly*, *formally* or *informally*. (*Poblete v. Lo Singco*, 44 Phil. 369).

Tabar v. Becada
44 Phil. 169

FACTS: A promised B that if B's daughter would serve him (A) in his house, A would give to said daughter some of his properties if and when she decided to get married to the man of her choice. Subsequently, the daughter rendered services to A in his house. **Issue:** Is there acceptance of the stipulation by a third party?

HELD: Yes, for the rendition of the services can be considered an implied acceptance of the stipulation.

- (i) If the principal contract of which the stipulation forms part is void, the stipulation is generally also void. If because of

vitiated consent, the principal contract is annulled, the stipulation also ceased to be effective.

- (j) Any party as well as the beneficiary of the stipulation. (*Florentino v. Encarnacion, Sr., 79 SCRA 196*).

(6) The Third Exception — where a third person induces another to violate his contract. (*Art. 1314, Civil Code*).

(7) The Fourth Exception — where in some cases, third persons may be ADVERSELY AFFECTED by a contract where they did not participate.

- (a) This is clearly evident in the case of COLLECTIVE CONTRACTS, where the majority naturally rules over the minority.

(b) *Examples:*

- 1) in collective bargaining contracts by labor organizations under Rep. Act 875.
- 2) in *suspension of payments* and compositions under the Insolvency Law. (*Act 1956, Secs. 11 and 63*).

(c) Other instances where strangers may be adversely affected are the following:

- 1) In the quasi-contract of “*negotiorum gestio*,” some contracts entered into by the unauthorized manager (*gestor*) may bind the owner. (*See Arts. 2150-2151, Civil Code*).
- 2) In a contract which creates a *status*, the whole world must respect such status. (Thus, when X marries Y, the whole world must realize that the marriage subsists, and that to have carnal knowledge with the wife would not result in the commission of adultery.) (*See Reyes & Puno, Outline of Civil Law, Vol. 4, p. 181*).
- 3) Real rights over real property must be *respected* by third persons if said rights are registered or if the third person has actual knowledge of the existence of such rights, actual knowledge being equivalent to registration. (*See Art. 1312, Civil Code*).

Example:

A leased his land to B. The lease right was duly recorded in the Registry of Property. If A subsequently sells the land to C while the lease still subsists, must C respect the lease?

ANS.: Yes, even if C did not participate in the lease contract. This is because the land has now come into his possession, and there being a duly registered real right thereon, he must respect said real right. (See Art. 1312, *id.*).

(8) The Fifth Exception — where the law authorizes the creditor to sue on a contract entered into by his debtor (*“accion directa”*).

- (a) *Example:* Even if a lessor does *not* have to respect a sub-lease, still the “*sub-lessee* is subsidiarily liable to the lessor for any rent due from the lessee.” (Here is an instance where the lessor can sue the sub-lessee.) (Art. 1652, *Civil Code*). Moreover, “without prejudice to his obligation toward the *sub-lessor*, the *sub-lessee* is bound to the lessor for all acts which refer to the use and preservation of the thing leased in the manner stipulated between the lessor and the lessee.” (Art. 1651, *Civil Code*).
- (b) Another example is that given under Art. 1729 of the Civil Code which states: “Those who put their *labor upon* or *furnish materials* for a piece of work undertaking by the contractor have an action *against the owner* up to the amount owing from the latter to the contractor at the time claim is made. However, the following shall not prejudice the laborers, employees, and furnishers of materials:
 - “(1) Payment made by the owner to the contractor before they are due;
 - (2) Renunciation by the contractor of any amount due him from the owner. This article is subject to the provisions of special laws.” (See *Reyes & Puno, supra.*).

Velasco, et al. v. Court of Appeals
L-47544, Jan. 28, 1980

A house owner, even if he did not participate therein, is bound by the contracts entered into be-

tween contractors on the one hand, and laborers or materialmen on the other hand, such that the owner may be held liable for payment by such laborers or materialmen. This is an exception to the rule on privity of contracts enunciated in Art. 1311 of the Civil Code, and is justified by the provision of Act 3959 and Art. 2242(3 and 4) of the Civil Code.

Art. 1312. In contracts creating real rights, third persons who come into possession of the object of the contract are bound thereby, subject to the provisions of the Mortgage Law and the Land Registration Laws.

COMMENT:

(1) Contracts Creating Real Rights

This Article constitutes one of the exceptions to the general rule that a contract binds only the parties.

(2) Reason for the Article

A real right binds the property over which it is exercised.

(3) Example

If A should purchase an apartment house from the owner but there is a lease thereon, A must respect the lease, if the same is registered in the Registry of Property, or if A has actual knowledge of the *existence* and *duration* of the lease. Similarly, the purchaser of land must respect a mortgage constituted thereon, under the same circumstances given hereinabove.

Art. 1313. Creditors are protected in cases of contracts intended to defraud them.

COMMENT:

(1) Right of Defrauded Creditors

This Article represents another instance when an outsider can in a sense interfere with another's contract.

(2) Example

If *A* gratuitously gives *B* a parcel of land, and *A* has no other property or cash left to satisfy his creditors, said creditors may ask for the *rescission* of the contract, to the extent that they have been prejudiced. (*See Arts. 1177, 1381, and 1387, Civil Code*).

Art. 1314. Any third person who induces another to violate his contract shall be liable for damages to the other contracting party.

COMMENT:**(1) Rule if Contract Is Violated Thru Inducement of Third Person**

This Article gives an instance when a stranger to a contract can be sued in view of his unwarranted interference. Whoever is injured may properly sue for damages. (*Gilchrist v. Cuddy, 29 Phil. 542*).

(2) Example

S, a movie actress, has a one-year contract with XYZ Studio. If *F*, a friend of *S* induces her, without any justifiable cause, to break the contract, then XYZ Studio can sue *F* for damages.

[NOTE: In the example given, the liability of *F* does not arise *ex-contractu* for he was not a party to the contract. (*See Daywalt v. Corporacion, 39 Phil. 587*).]

[NOTE: In the same example, *F* cannot be held liable for greater damages than *S*. A contrary answer would “lead to result at once grotesque and unjust.” (*Daywalt v. Corporacion, 39 Phil. 587*). In the opinion of the Code Commission, *F*’s liability would, at most, be solidary with *S* because of his commission of a *tort*. (*Code Com. Memorandum to Joint Congressional Committee on Codification, March 8, 1951*).]

(3) Case

**Yu v. CA, et al.
GR 86683, Jan. 21, 1993**

FACTS: Petitioner, the exclusive distributor of the House of Mayfair wall-covering products in the Philippines, cried foul

when his former dealer of the same goods, herein private respondent, purchased the merchandise from the House of Mayfair in England thru FNP Trading in West Germany and sold said merchandise in the Philippines. Both the court of origin and the appellate court rejected petitioner's thesis that private respondent was engaged in a sinister form of unfair competition within the context of Art. 28 of the Civil Code.

In the suit for injunction which petitioner filed before the RTC-NCR stationed in Manila, petitioner pressed the idea that he was practically by-passed and that private respondent acted in concert with the FNP Trading in misleading Mayfair into believing that the goods ordered by the trading firm were intended for shipment to Nigeria although they were actually shipped to and sold in the Philippines. Private respondent professed ignorance of the exclusive contract in favor of petitioner. Even then, private respondent responded by asserting that petitioner's understanding with Mayfair is binding only between the parties thereto.

Nevertheless, one circumstance which respondent court overlooked was petitioner's suggestion, which was not disputed by herein private respondent in its comment, that the House of Mayfair in England was duped into believing that the goods ordered thru the FNP Trading were to be shipped to Nigeria only, but the goods were actually sent to and sold in the Philippines.

HELD: A ploy of this character is akin to the scenario of a third person who induces a party to renege on or violate his undertaking under a contract, thereby entitling the other contracting party to relief therefrom. (*Art. 1314, Civil Code*). The breach caused by private respondent was even aggravated by the consequent diversion of trade from the business of petitioner to that of private respondent caused by the latter's species of unfair competition, as demonstrated no less by the sales effected in spite of this Court's restraining order.

This brings us to the irreparable mischief which respondent court misappreciated when it refused to grant the relief simply because of the observation that petitioner can be fully compensated for the damage. *A contrario*, the injury is irreparable where it is continuous and repeated since from its constant

and frequent recurrence, no fair and reasonable redress can be had therefor by petitioner insofar as his goodwill and business reputation as sole distributor are concerned. Withal, to expect petitioner to file a complaint for every sale effected by private respondent will certainly court multiplicity of suits.

Art. 1315. Contracts are perfected by mere consent, and from that moment the parties are bound not only to the fulfillment of what has been expressly stipulated but also to all the consequences which, according to their nature, may be in keeping with good faith, usage, and law.

COMMENT:

(1) Consensuality of Contracts

The Article stresses the **CONSENSUALITY OF CONTRACTS** (or perfection by *mere consent*).

**Salvador P. Malbarosa v. CA and S.E.A.
Development Corp.
GR 125761, Apr. 30, 2003**

FACTS: From March 16, 1990 to April 3, 1990, petitioner had more than two weeks to accept the offer of respondent. Although petitioner avers that he had accepted the offer of respondent on March 28, 1990, however, he failed to transmit to respondent the copy of the March 14, 1990 letter-offer bearing his conformity thereto.

HELD: Unless and until the respondent received said copy of the letter-offer, it cannot be argued that a contract had already been perfected between petitioner and respondent.

A contract is perfected only from the time an acceptance of an offer is made known to the offeror. An offer made *inter praesentes* must be accepted immediately. If the parties intended that there should be an express acceptance, the contract will be perfected only upon knowledge by the offeror of the express acceptance by the offeree of the offer. An acceptance which is not made in the manner prescribed by the offeror is not effective but constitutes a counter-offer which the offeror may accept or reject.

The contract is not perfected if the offeror revokes or withdraws its offer and the revocation or withdrawal of the offeror is the first to reach the offeree. The acceptance by the offeree of the offer after knowledge of the revocation or withdrawal of the offer is inefficacious.

(2) How Contracts Are Perfected

- (a) *consensual contracts* — by mere consent (this is the general rule) (*Art. 1315*). (*Example*: contract of sale)
- (b) *real contracts* — perfected by delivery (*Examples*: deposit and pledge). (*Art. 1316, Civil Code*).
- (c) *formal or solemn contracts* — here a special form is required for perfection (*Example*: A simple donation *inter vivos* of real property, to be valid and perfected, must be in a public instrument). (*Art. 749, Civil Code*). [*NOTE*: To be a written contract, all its terms must be in writing, so that a contract partly in writing and partly oral is, in legal effect, an oral contract. (*Manuel v. Rodriguez, et al., L-13435, Jul. 26, 1960*).]

(3) Perfection of Consensual Contracts

Consensual contracts are perfected from the moment there is agreement (consent) on the *subject matter*, and the *cause* or *consideration*.

Lirag Textile Mills, Inc. v. Reparations Commission L-22768, Oct. 28, 1977

When a contract to purchase from the Reparations Commission is still subject to a series of tedious steps such as the conclusion of an annual procurement program, the obtaining of authority from a higher office (like the Philippine Reparations Mission in Japan), and the stipulating of what the rate of exchange should be, there is as yet *no perfected contract of sale*.

(4) Consequences of Perfection

- (a) The parties are bound to the fulfillment of what has been EXPRESSLY STIPULATED (*Art. 1315, Civil Code*), and

compliance thereof must be in GOOD FAITH. (*Art. 1159, Civil Code*).

[*NOTE*: If the true intention is not expressed in a written agreement, in case one has been made, the proper remedy is REFORMATION. (*Art. 1359, Civil Code*).]

- (b) The parties are ALSO bound to all the CONSEQUENCES which, according to their nature, may be in keeping with GOOD FAITH, USAGE, and LAW.

Vda. de Murciano v. Aud. Gen., et al.
L-11744, May 28, 1958

FACTS: The Armed Forces of the Philippines occupied a parcel of land belonging to Vda. de Murciano. To indemnify her for this occupancy, the Office of the Chief of Engineers forwarded to her for her signature a quit-claim agreement whereby she was to be paid the amount of P15,067.31 as complete payment. Plaintiff signed said agreement on Apr. 4, 1951, and returned the same to the Office of Engineers. Before it could be signed by the Commanding Officers of the Philippine Service Command in representation of the Republic, the armed forces was reorganized, and the Chief of Staff refused to sign it on the ground that the woman was entitled to only P7,000. *Issue*: Is the Armed Forces liable for the first amount of P15,067.31?

HELD: Yes, for the contract was perfected from the time the Armed Forces received the woman's acceptance of its offer. The refusal of the Chief of Staff does not in the least affect her right to ask for fulfillment of the perfected agreement. The absence of a writing does not preclude the binding effect of the contract duly perfected by a meeting of the minds, the contract not being of the class called "formal" or "solemn."

Vicente & Michael Lim v. CA & Liberty H. Luna
GR 118347, Oct. 24, 1996
75 SCAD 574

Private respondent fails to distinguish between condition imposed on the perfection of the contract and a condi-

tion imposed on the performance of an obligation. Failure to comply with the first condition results in the failure of a contract, while failure to comply with the second condition only gives the other party the option either to refuse to proceed with the sale or to waive the condition.

Indeed, private respondent is not the injured party. She cannot rescind the contract without violating the principle of mutuality of contracts, which prohibits allowing the validity and performance of contracts to be left to the will of one of the parties.

Art. 1316. Real contracts, such as deposit, pledge and *commodatum*, are not perfected until the delivery of the object of the obligation.

COMMENT:

(1) Perfection of Real Contracts

Real contracts require *consent, subject matter, cause or consideration*, and DELIVERY.

(2) Delivery as a Requisite

Delivery is required of the very *nature* of the contract. (8 *Manresa* 637). For *example*, a *depository* cannot be expected to comply with his obligation of keeping the object safely unless and until it is *delivered* to him.

(3) The Real Contracts Referred to

The *real contracts* referred to in Art. 1316 are:

- (a) DEPOSIT
- (b) PLEDGE
- (c) *COMMODATUM*, a loan where the *identical* object must be returned (*Example*: Loan of a car)

(4) Future Real Contracts as Consensual Contracts

A contract “to make a deposit, to make a pledge, or to make

a *commodatum*” is a *consensual* contract. After delivery, the contract becomes a *real contract*.

Example: A agreed to lend B his (A’s) car on Sept. 8. If on Sept. 8 A refuses to deliver the car, may B sue him for damages?

ANS.: Yes, because of the *consensual contract* of “to make a *commodatum*.” If A had delivered the car and B thru negligence damages the car, A can sue him because of the *real contract* of “*commodatum*.”

[NOTE: Similarly, “an agreement (consensual) to constitute a *deposit* is binding, but the *deposit* itself (the real contract of deposit) is not perfected until the delivery of the thing.” (Art. 1963, *Civil Code*).]

(5) The Contract of Carriage

- (a) The contract “to carry” (at some future time) is *consensual* and is perfected by mere consent.
- (b) The contract of “carriage” is a *real contract*, for not until the carrier is actually used can we consider the contract perfected, that is, ‘til the moment of actual use, the carrier cannot be said to have already assumed the obligation of a carrier.

[NOTE: The real contract of carriage is perfected even if the passenger has not yet paid, in fact, even if he has no money for his fare. (See *Barker v. Ohio River R. Co.*, 51 W. Va. 423). It does not even matter that he has not boarded the vehicle completely. The all-important fact is that he has, with the express or implied consent of the carrier, placed a part of his body, or a portion of the goods on any part of the jeepney, taxi or bus, such as the stepping platform or the running board. (See *Illinois C. R. Co. v. O’Keefe*, 68 Ill. 115).]

Art. 1317. No one may contract in the name of another without being authorized by the latter, or unless he has by law a right to represent him.

A contract entered into in the name of another by one who has no authority or legal representation, or who has acted

beyond his powers, shall be unenforceable, unless it is ratified, expressly or impliedly, by the person on whose behalf it has been executed, before it is revoked by the other contracting party.

COMMENT:

(1) Requisite for a Person to Contract in the Name of Another

If a person wants to contract in the name of another —

- (a) he must be duly authorized (expressly or impliedly)
- (b) OR he must have by law a *right to represent him* (like the guardian, or the administrator)
- (c) OR the contract must be *subsequently* RATIFIED (expressly or impliedly, by word or by deed). (*See Gutierrez Hermanos v. Orense, 28 Phil. 898*).

**Monteverde v. Court of Industrial Relations
79 SCRA 269**

Unless he has been given special authority to do so, a lawyer cannot compromise his client's case nor can he discharge his client's claim without a cash settlement for the full amount of the claim.

(2) Example of an UNAUTHORIZED (a Form of UNENFORCEABLE CONTRACT) CONTRACT

In Jose's name, but without Jose's authorization, Maria sold Jose's car to Marilyn. The sale of the car is unauthorized.

[NOTE: In the example given, *mere lapse of time* cannot cure the defect; this is *not* the ratification required by the law. (*Tipton v. Velasco, 6 Phil. 67*).]

[NOTE: The death of the principal does NOT render the act of an agent unenforceable, where the agent had no knowledge of such extinguishment of the agency. (*Herrera, et al. v. Luy Kim Guan, et al., L-17043, Jan. 31, 1961*).]

Badillo v. Ferrer
GR 51369, Jul. 29, 1987

FACTS: Macario died intestate in 1966, survived by his widow, Clarita, and five minor children. He left a parcel of land. In 1967, Clarita, in her own behalf and as natural guardian of the minor plaintiffs, executed a deed of extrajudicial partition and sale of the property through which she sold the property to Gregorio. In 1968, Modesta, a sister of Macario, was able to obtain guardianship over the property and persons of the minor children. In 1970, the guardian caused the minor children to file a complaint to annul the sale of their participation in the property and asked that as co-owners they be allowed to exercise the right of legal redemption with respect to Clarita's participation therein. The trial court annulled the sale to Gregorio of the minor children's participation in the property and allowed them to redeem the participation of their mother therein.

HELD: The Supreme Court sustained the annulment of the sale with respect to the children's participation. The deed of extrajudicial partition is unenforceable, or more specifically, an unauthorized contract under Arts. 1403[1] and 1317 of the New Civil Code. Clarita has no authority, *i.e.*, she acted beyond her powers in conveying to Gregorio the undivided share of her minor children in the property. The powers given to her by the law as the natural guardian cover only matters of administration and cannot include the power of disposition. The children never ratified the deed of partition and sale. Hence, the contract remained unenforceable or unauthorized. No restitution may be ordered from the minors either as to that portion of the purchase price which pertains to their share in the property or at least as to that portion which benefited them because the law does not sanction any.

(3) Implied Ratification

Ratification can be implied from acts, such as when the owner of a *hacienda* which was sold to strangers *without* his authority, collected the amount in a promissory note given as purchase price (*Tacalinar v. Corro*, 34 Phil. 898), or when the Board of Directors of a private corporation should take advantage of the benefits derived from an authorized contract entered into

by its President. The Corporation is thus bound even without a formal resolution on the matter. (*Buenaseda v. Bowen and Co., Inc., et al.*, L-14985, Dec. 29, 1960).

(4) Effect of Ratification

Ratification cleanses the contract from all its defects from the moment the contract was entered into. (*Art. 1396, Civil Code*). Hence, there is a *retroactive* effect. (*Tacalarin v. Corro*, 34 Phil. 898).

[NOTE: There can be no more ratification if the contract has previously been REVOKED by the other contracting party. (*Art. 1317, par. 2*).]

(5) Effect When an Unauthorized Person Does Not Really Need the Authority

If a lawyer, without his client's authority, signs a "*compromise*" contract (which is *not* really a compromise for what were stipulated were only rights and obligations provided for by law — and hence *no reciprocal concession was really involved*). The contract would bind the client, *not* because of the "compromise" but because of the legal provisions involved. (*Merced v. Roman Catholic Archbishop of Manila*, GR 24616, Aug. 17, 1967).

(6) Case

**Benjamin Coronel & Emilia Meking Vda. de
Coronel v. Florentino Constantino, Aurea
Buensuceso, & CA
GR 121069, Feb. 7, 2003**

FACTS: No evidence was presented to show that the three brothers were aware of the sale made by their mother. Their mother, Emilia, executed the instrument in her own behalf and not in representation of her three children. It has been established that at the time of execution of the "*Kasulatan ng Bilihang Patuluyan*" on April 23, 1981 the subject property was co-owned, *pro-indiviso*, by petitioner Emilia together with her petitioner-son Benjamin, and her two other sons, Catalino and

Ceferino. No proof was presented to show that the co-ownership that existed among the heirs of Ceferino and Catalino and herein petitioners has ever been terminated.

Applying Arts. 1317 and 1403, respectively, the Court of Appeals ruled that thru their inaction and silence, the three sons of Emilia are considered to have ratified the aforesaid sale of the subject property by their mother.

HELD: The Supreme Court disagrees with the appellate court, ruling that the three sons of Emilia did not ratify the sale. Unaware of such sale, Catalino, Ceferino, and Benjamin could not be considered as having voluntarily remained silent and knowingly chose not to file an action for the annulment of the sale. Their alleged silence and inaction may not be interpreted as an act of ratification on their part.

Ratification means that one under no disability voluntarily adopts and gives sanction to some unauthorized act or defective proceeding, which without his sanction would not be binding on him. It is this voluntary choice, knowingly made, which amounts to a ratification of what was, therefore, unauthorized, and becomes the authorized act of the party so making the ratification.

Chapter 2

ESSENTIAL REQUISITES OF CONTRACTS

GENERAL PROVISIONS

Art. 1318. There is no contract unless the following requisites concur:

- (1) **Consent of the contracting parties;**
- (2) **Object certain which is the subject matter of the contract;**
- (3) **Cause of the obligation which is established.**

COMMENT:

(1) Essential Requisites of Consensual Contracts

The three essential requisites for *consensual* contracts are enumerated in this Article.

(*NOTE:* Under the old Civil Code, “consideration” was the word used instead of “cause of the obligation.”)

(2) Real Contracts

Real contracts require a *fourth* requisite — DELIVERY.

(3) Solemn or Formal Contracts

Solemn or formal contracts require a fourth requisite — COMPLIANCE WITH THE FORMALITIES REQUIRED BY LAW. (*Example:* A simple donation *inter vivos* of land requires a public instrument for its perfection.)

(4) What Consent Presupposes

Consent presupposes *legal capacity* (8 *Manresa* 646) and the fulfillment of *conditions*, should any be attached. (*Ruperto v. Kosca*, 26 *Phil.* 227).

(5) Effect of Non-Consent

- (a) If there is absolutely no consent (as in the case of a JOKE), there is no contract. The agreement may be considered *inexistent* or *non-existent* or *VOID*. (The same rule applies in the case of *absolutely simulated contract*, one where the parties never intended to be bound.)
- (b) If there is a *vice of consent* (vitiating consent) such as error, fraud, or undue influence, *etc.*, the contract is *not* void; it is merely voidable.

(6) Transportation Ticket as a Contract

Peralta de Guerrero, et al. v. Madrigal Shipping Co.
L-12951, Nov. 17, 1959

A transportation *ticket* is a complete written contract between the shipper and the passenger since it has all the elements of a complete contract: (a) the consent of the contracting parties manifested by the fact that the passenger boards the ship and the shipper consents or accepts him in the ship for transportation; (b) cause or consideration, which is the fare paid by the passenger, as stated in the ticket; and (c) object, which is the transportation of the passenger from the place of departure to the place of destination as stated in the ticket.

(7) Lack of Consent Is Separate and Distinct From Lack of Consideration

Rido Montecillo v. Ignacia Reynes & Spaires
Redemptor & Elisa Abucay
GR 138018, Jul. 26, 2002

The manner of payment of the purchase price is an essential element before a valid and binding contract of sale can exist. Although the Civil Code does not expressly state that the

minds of the parties must also meet on the terms or manner of payment of the price, the same is needed, otherwise there is no sale. Agreement on the manner of payment goes into the price such that a disagreement on the manner of payment is tantamount to a failure to agree on the price. (*Toyota Shaw, Inc. v. CA*, 244 SCRA 320 [1995]).

One of the three essential requisites of a valid contract is consent of the parties on the object and cause of the contract. In a contract of sale, the parties must agree not only on the price, but also on the manner of payment of the price. An agreement on the price but a disagreement on the manner of its payment will not result in consent, thus, preventing the existence of a valid contract for *lack of consent*. This lack of consent is separate and distinct from *lack of consideration* where the contract states that the price has been paid when in fact, it has never been paid.

Section 1

CONSENT

Art. 1319. Consent is manifested by the meeting of the offer and the acceptance upon the thing and the cause which are to constitute the contract. The offer must be certain and the acceptance absolute. A qualified acceptance constitutes a counter-offer.

Acceptance made by letter or telegram does not bind the offerer except from the time it came to his knowledge. The contract, in such a case, is presumed to have been entered into in the place where the offer was made.

COMMENT:

(1) Consent as an Essential Requisite

This Article emphasizes CONSENT, which is the first essential requisite of every contract.

(2) ‘Consent’ Defined

- (a) It is the *meeting of the minds* between the parties on the *subject matter* and the *cause* of the contract, even if neither one has been delivered.

- (b) It is the manifestation of the meeting of the *offer* and the *acceptance* upon the *thing* and the *cause* which are to constitute the contract. (*Art. 1319, 1st par.*).

Example:

A offered to sell B a particular car for P2,000,000. Before B could consent, A withdrew the offer. Was A allowed to do so?

ANS.: Yes, because there was NO meeting of the minds yet, hence no contract had been perfected.

(3) Requisites of Consent

- (a) There must be two or more parties.

[NOTE: One person may represent two or more parties, unless there are contradictory or prejudicial interests involved. (*See Art. 1490, Civil Code; Garchitorena v. Sotelo, 74 Phil. 25.*)]

- (b) The parties must be *capable* or *capacitated* (hence, if one party be *insane*, the contract is merely voidable).
 (c) There must be no *vitiating of consent*.

(*Example:* There must be no fraud or intimidation, otherwise the contract is *voidable*.)

- (d) There must be *no conflict* between what was expressly declared and what was really intended. Otherwise, the remedy may be reformation, as when the parties really intended to be bound, or else the contract is VOID, as when the contract is *fictitious* or *absolutely simulated*.
 (e) The intent must be declared *properly* (that is, whatever legal formalities are required must be complied with).

Roberto Escay, et al. v. Court of Appeals, et al.
L-37504, Dec. 18, 1974

Conformity to an *original* contract generally presupposes conformity to a *subsequent* contract executed precisely to cure a defect in the original contract (such as the

failure to state the cause or consideration of said original contract).

LCC Corporation v. Farrales
L-39804, Apr. 17, 1984

If a person does not enter into a contract for delivery of certain articles, he cannot be held responsible for the non-payment of the goods. After all, there is no privity of contract referred to in the problem.

(4) Requisites for the Meeting of the Minds

- (a) an offer that must be CERTAIN;
- (b) and an acceptance that must be UNQUALIFIED and ABSOLUTE.

(NOTE: If the acceptance is qualified, let us say by a condition, this merely constitutes a COUNTER-OFFER.)

(5) An Offer That Is CERTAIN

In order that an offer can be considered CERTAIN, it must *not be vague, misleading, or made as a joke*. Therefore, a declaration of a person of “his intention to enter into a contract” is not an offer that is CERTAIN. (*Rosenstock v. Burke*, 46 Phil. 217). If the offer is withdrawn before it is accepted, there is no meeting of the minds. (*Jose Benares, et al. v. Capitol Subdivision, Inc.*, L-7330, Nov. 29, 1960).

Rosenstock v. Burke
46 Phil. 217

FACTS: A letter began as follows: “In connection with the yacht Bronzewing, I am in position and am *willing* to entertain the purchase of it under the following terms.” **Issue:** Was there an offer here that was certain, an offer which, if accepted, could compel the writer to really buy the yacht?

HELD: No, because here the offer was neither definite nor certain. Said the Supreme Court: “To convey the idea of a resolution to purchase, a man of ordinary intelligence and common culture would use these clear and simple words: ‘I offer to

purchase,' 'I want to purchase,' 'I am in position to purchase. . . .' It must be presumed that a man in his transactions in good faith used the best means of expressing his mind that his intelligence and culture so permit as to convey and exteriorize his will faithfully and unequivocally. The word 'entertain' applied to an act does *not* mean the resolution to perform said act, but simply a position to deliberate for deciding to perform said act. It was not a definite or certain offer, but a mere invitation to a proposal being made to him, which might be accepted by him or not."

[NOTE: If two contracts are offered, but they are *independent* of each other (such as a sale of a parcel of land, and the lease of an automobile), acceptance of one does not imply acceptance of the other. BUT if one contract depends upon another, like a contract of loan provided it is secured by a contract of mortgage, it is essential that there be an agreement on BOTH transactions. Otherwise, there can be as yet no meeting of the minds. (See 8 Manresa 652).]

Venturanza and Price v. Canizares, et al.
L-13396, Oct. 22, 1958

If an offer is made to buy property at a certain price but "in the event that the bid of any other offeror shall be considered to be the best in terms of the amount offered and the conditions stipulated therein," the offerer is "willing and agreeable to *equal or to improve* the said 'best offer' by *adding* another certain amount," it cannot be denied that the amount offered is *speculative* and not a definite offer which is definite and not speculative.

Consolidated Mills, Inc. v. Reparations Commission
76 SCRA 18

Before the completion of the steps for the purchase of reparation goods, any agreement between the Reparations Commission and the end-user is thereby a simple preliminary transaction that has no obligatory effect. The agreement becomes complete when the procurement of the goods in behalf of the end-user becomes absolutely certain with the availability of the reparation goods.

(6) An Acceptance That Is UNQUALIFIED and ABSOLUTE

- (a) If there is completely no acceptance or if the offer is expressly rejected, there is no meeting of the minds. (*Lequinco v. Postal Savings Bank*, 47 Phil. 772 and *Gamboa v. Gonzales*, 17 Phil. 381). If the acceptance be qualified or not absolute, there is no concurrence of minds. There merely is a counter-offer. (*Batangan v. Cojuangco*, 78 Phil. 481 and Art. 1391, Civil Code). If one promises to act as surety for another's obligation as an *agent*, he does not answer for the latter's obligation as a purchaser. (*Pacific Tobacco Corporation v. Court of Appeals & Manila Surety & Fidelity Co., Inc.*, L-10894, Mar. 24, 1958).
- (b) *Examples*

A went to a store and offered to buy a certain watch for P100,000. The seller said he was willing to give it for P120,000. Whereupon, A turned to go away because he did not want to pay that price. The seller called him back and said he was willing to sell the watch for P100,000. Is A allowed not to buy said watch?

ANS.: Yes. A's offer was P100,000. This was not accepted. Or granting that the proposal of P120,000 was a sort of acceptance, the statement that the buyer could have it for P120,000 was not absolute. It was a qualified acceptance and hence, under the law, constitutes a *counter-offer*. Hence, when the seller said P120,000, he was not really accepting the offer to buy. Now, when he was going to give it for P100,000, he was not really accepting the offer of A, but was making another offer, a counter-offer since the offer made by A previously had been rejected by him (the seller).

[NOTE: A counter-offer as a matter of fact *extinguishes* the offer. Moreover, it may or may not be accepted by the original offeror. (See *Trillana v. Quezon Colleges*, L-5003, Jun. 27, 1953).]

Cornejo v. Calupitan
48 O.G. 621, Feb. 1952

FACTS: On Jan. 4, 1945, Cornejo offered to buy Calupitan's land for P650,000 (in Japanese money) with a

deposit of P70,000. The balance was to be paid on or before Jan. 19, 1945. Calupitan agreed. But on Jan. 6, 1945, the buyer gave only P65,000 as deposit instead of P70,000, and he wrote to Calupitan that the balance was to be paid on January 25, 1945. Calupitan agreed to this new plan, but imposed the condition that said balance should be given in genuine Philippine money. On Jan. 22, 1945, Cornejo wanted to give the balance in *Japanese money* but he could not find Calupitan, so he consigned said balance in court. At the same time, he sued Calupitan for specific performance and damages.

HELD: The action will not prosper. The first agreement was abandoned by Cornejo himself when he did *not* comply with his promise. The second proposal was not perfected, for the acceptance was conditional, namely, the giving of the balance in genuine Philippine currency.

Zayco v. Serra
44 Phil. 326

FACTS: Serra offered to sell a Central either for cash, or on an installment basis, the balance to be paid in three years. The total price was P1,000,000. Zayco, to whom the Central was offered, wrote to Serra stating among other things that he was giving P100,000 or 1/10 of the price as downpayment, the balance to be paid in some other way. *Issue:* Was there a meeting of the minds?

HELD: No, there was no meeting of the minds for when Zayco offered P100,000 as downpayment, this was really a *qualified* acceptance, because Serra's offer did *not* specify how much should be the initial payment. When Zayco offered P100,000 and not any other amount as downpayment, this was in the nature of a proposal by itself.

**Meads v. Land Settlement and
Development Corporation**
98 Phil. 119

FACTS: In an offer of barter involving second-hand sawmill equipment and additional spare parts valued

at P12,000 on the one hand and an as yet undetermined number of tractors of various qualities on the other hand, the offeree, the Land Settlement and Development Corporation, answered: “We are *willing* to accept the proposition, in which case *please see our* Mr. F.J. Domatay, of the Property Department for possible arrangement.” *Issue*: Was there a meeting of the minds here?

HELD: No, there was no meeting of the minds for the above-mentioned clause did not in any manner show that the corporation had definitely accepted the offer. The phrase “willing to accept” merely indicated a disposal to accept in *principle* subject to *certain considerations*, such as the examination of the second-hand sawmill and the spare parts; the determination of the number and quality of tractors to be given in exchange, the possibility of bargaining — all of which required consultations and “a possible arrangement.”

Batangan v. Cojuangco
78 Phil. 481

FACTS: An attempted compromise at the figure of P1,508.28 in cash was met with a tender and payment of P800. *Issue*: Was there a meeting of the minds?

HELD: No, because of the substantial variance in the amount contained in the offer, and in the amount tendered. For perfection, the offerer has first to assent to the suggested modification caused by the reduction in the price.

Datoc v. Mendoza, et al.
(C.A.) 47 O.G. 2427

FACTS: Would-be buyers, knowing fully well that they could not pay the required P2,000 asked of them at once and totally, nevertheless answered YES, keeping this mental reservation to themselves. *Issue*: Was there a meeting of the minds?

HELD: There was no meeting of the minds in view of the mental reservation. And granting that there was, still the presence of *causal fraud (dolo causante)* necessarily voids the contract.

Halili v. Lloret, et al.
95 Phil. 78

FACTS: While still in the *process of negotiation*, the offeree *legally* suspended the payment of the check it had issued for failure of the offerer to sign certain documents.
Issue: Was there a contract here?

HELD: No, because the legal suspension of the check payment clearly indicates that the transaction was merely in the stage of negotiation; otherwise, the offeree would *not* have been allowed to legally withdraw from the payment.

Montinola v. Victorias Milling Co., et al.
54 Phil. 782

FACTS: In order to encourage efficient sugar production, the Victorias Milling Company, which was operating a sugar central, conducted a contest, complete with written rules. Montinola joined the contest, but because he failed to follow some of the rules, the Company had no alternative except to disqualify him for any prize. He now alleges lack of authority on the part of the Company to disqualify him.

HELD: Under the law, the offerer may fix the time, place, and manner of acceptance. (*See Art. 1321*). Because Montinola violated the rules, it cannot be said that there was a meeting of the minds. Therefore, he could properly be *disqualified*. Indeed, the basis of the right to a reward is in the nature of a contract and rests on one side upon conditions. (*34 Cyc. 1731*). In *competitive contests* for rewards, the acceptance must be in strict conformity with the offer, and a *qualified acceptance* does *not* create a contract.

American President Lines, Ltd.
v. Richard A. Klepper
L-15671, Nov. 29, 1960

The act of the owner in shipping his goods on board the ship of the carrier, and in paying the corresponding

freight thereon, shows that he *impliedly* accepted the contract — the bill of lading — which had been issued in connection with the shipment in question. It may be said therefore that the same is binding upon him as if it had been actually signed by him or by any other person in his behalf.

Clarín v. Rulona
L-30786, Feb. 20, 1984

- (1) Where a party to a contract of sale *accepts payment*, this is an indication that said party has given his consent to the contract.
- (2) The contract is valid even if one of the parties states that he entered into it against his better judgment.
- (3) A co-owner cannot sell a definite part of the co-ownership. (*NOTE: In the instant case, however, the Supreme Court unfortunately forgot that the share being sold by the co-owner concerned was a definite part since the share referred to that portion on which his house had been constructed as already intimated, the sale was deemed VALID*).

(7) Query

A offered 20 fountain pens to *B* for P1,000 each. *B* answered by letter that he was willing to purchase 30 fountain pens at said price at P1,000 each. Is the contract perfected?

ANS.: It depends:

- (a) If *B* wanted 30 pens and would not be satisfied with less, the acceptance can be considered as qualified, so there has been *no* perfection yet.
- (b) If *B* was contented with 20 pens, but desired, if possible to get 10 more, there is a perfected sale regarding the original 20, and an offer with respect to the extra ten. Unless accepted in turn, there would be *NO* contract yet with respect to the additional 10 fountain pens. (*See Tolentino, Civil Code of the Phil., Vol. V, p. 413*).

[NOTE:

If an offerer offers several *distinct* and *separate* items, and the offeree accepts *one* of them, the contract is perfected as to the item accepted. Thus, if a contractor offers to the RFC to construct a building for P389,980 complete with all installations; for P18,900 if no building but only electrical installations are to be made; for P12,600 if no building but only for plumbing installations and the RFC awards it a contract only for the plumbing installations (P12,600), the contract is *perfected* insofar as said plumbing installations are concerned. This is so because the proposal of the contractor consisted of several items, each one of them complete in itself, and distinct, separate, and independent from the other items. It *cannot* be said that there was a modification of the offer or only a partial acceptance thereof. Indeed, the award given by the RFC was an unqualified acceptance of the third item, which item constituted a complete offer by itself. (*Valencia v. Rehabilitation Finance Corporation, et al.*, L-10749, Apr. 25, 1958).]

(8) Acceptance Thru Correspondence

- (a) *Rule:* “Acceptance made by letter or telegram does not bind the offerer *except* from the time it came to his *knowledge*. The contract in such a case is presumed to have been entered into in the place where the offer was made.”
- (b) The knowledge may be actual or constructive (as when the letter of acceptance has been received in the house of the offerer by a person possessed of reasonable discernment). If actual knowledge be required, proof of this would be almost impossible, for even when the letter containing the answer has been opened and read, the offerer can always claim, in some cases *truthfully*, that while he was reading the same, his mind was elsewhere, and he did *not* actually know the contents of said answer.

(9) Cases**Laudico v. Arias
43 Phil. 270**

FACTS: On Feb. 5, 1919, Arias wrote Laudico a letter, offering a lease contract. On Mar. 6, 1919, Laudico wrote a letter

of complete acceptance, which was received by Arias that same *afternoon*. But that same *morning* Arias had already written Laudico a letter *withdrawing* the offer. *Issue*: Was there a contract here?

HELD: No, because prior to receipt of the letter of acceptance, the offer had already been withdrawn. In other words, it does not matter that the letter of withdrawal may have been received *later* by the offeree than receipt of the letter of acceptance by the offerer. What is important is that the letter of withdrawal was MADE prior to the knowledge of acceptance.

Sambrano v. Court of Tax Appeals
101 Phil. 1

FACTS: Sambrano was indebted to the government for P184,000 by way of tax liabilities. To guarantee this tax obligation, he executed a chattel mortgage. Because of his inability to pay he offered by way of compromise, the payment of P70,000 in cash, and P10,000 payable within 30 days. The Secretary of Finance favorably recommended the approval of the offer, and on Sept. 9, 1954, the Collector of Internal Revenue informed Sambrano's attorney of the acceptance of the offer. Apparently *unaware* of the acceptance, said attorney *withdrew* the offer on Sept. 24, 1954. Having been apprised of this move, the Secretary of Finance ordered the Collector to effect the collection of the entire tax liability. *Issue*: Was there a meeting of the minds on the compromise plan?

(*NOTE*: A compromise is considered by the Code to be a contract.)

HELD: No, there was no meeting of the minds because Sambrano thru his counsel *revoked* the offer *before he learned of its acceptance* by the Secretary of Finance and the Collector of Internal Revenue.

Ramon Magsaysay Award Foundation v. CA
GR 55998, Jan. 17, 1985

Even if the draft renewal contract had not been signed by the lessor, the parties may be deemed to have agreed to renew their lease contract considering the exchanges of letters between, and the implementing acts of, the parties.

(10) Rule if Letter of Acceptance Is Withdrawn or Revoked

A letter of acceptance may in turn be withdrawn or revoked.

PROBLEM:

A offered on Jan. 1. B accepted on Jan. 8. The letter of acceptance was received by A on Jan. 15. But on Jan. 12, B had already written a letter *revoking* the acceptance. Was there a meeting of the minds?

ANS.:

- 1) If the letter revoking the acceptance was received by A BEFORE Jan. 15 (receipt of the letter of *acceptance*), there is *no question* that there was no meeting of the minds. (*Reyes & Puno, supra., p. 186; Manresa and Tolentino, supra, p. 418*).
- 2) But if the letter revoking the acceptance, although made previously, was nevertheless received by A only AFTER Jan. 15 (receipt of the letter of acceptance), Reyes, Puno and Tolentino believe that there was already a meeting of the minds. Thus, Profs. Reyes and Puno say that the revocation of the acceptance “must reach and be learned by the offerer ahead of the acceptance.” (*Reyes and Puno, op. cit., p. 186*). Prof. Tolentino in turn says: “Where the offeree has sent his acceptance, but then sends a rejection or a revocation of the acceptance, which reaches the offerer BEFORE the acceptance, there is NO meeting of the minds, because the revocation has cancelled or nullified the acceptance which thereby ceased to have any legal effect.” (*Tolentino, op. cit., p. 418*). On the other hand, *Manresa* maintains the contrary view, for what is important is that at the time of receipt of the letter of acceptance, there had already been a *prior revocation* of said acceptance. In other words, at the exact moment of *alleged* meeting of the minds (Jan. 15), there really was NO concurrence of minds or wills.

An offer by *telegram* is governed NOW by the same rules for letters, but there was a time when to be valid it had to be followed by a *letter* of confirmation, unless the mode of communicating by telegram had previously been agreed upon in a written contract. (*See Engel v. Mariano Velasco and Co., 47 Phil. 115*).

Art. 1320. An acceptance may be express or implied.**COMMENT:****(1) Forms of Acceptance**

Acceptance may be:

- (a) *express* (Art. 1320);
- (b) *implied* (Art. 1320) from conduct, or acceptance of unsolicited services (*Perez v. Pomar*, 2 Phil. 682);
- (c) *presumed* (by law) as when there is failure to repudiate hereditary rights within the period fixed by law (*See Art. 1057, Civil Code*); or when there is SILENCE in certain specific cases as would tend to *mislead* the other party, and thus place the silent person in estoppel. (*See Arts. 1670, 1870, 1871, 1872 and 1873, Civil Code*).

(2) Examples of Implied Acceptance

- (a) An offer by the Army to reward persons giving information that would lead to the apprehension of certain Huks may be considered *implicitly accepted* when the act referred to it is performed by members of the public.
- (b) In the same way, participation in a *contest*, with full compliance of its rules, is implied acceptance of the offer. Thus, on one occasion, the Supreme Court has said that “due to the fact that the bank started, and advertised the contest offering prizes, under certain conditions and the plaintiff prepared, by labor and expense, and took part in said contest, the bank is bound to comply with its promise made in the rules and conditions prepared and advertised by it.” (*De la Rosa v. Bank of the Phil. Islands*, 51 Phil. 926).

(3) Implied Rejection

Upon the other hand, *refusal* or *rejection* of an offer may also be inferred from acts and circumstances, like the failure to act on an offer of compromise before the court enters final judgment on a case. (*Batangan v. Cojuangco*, 78 Phil. 481). Similarly, an offer to remit interest, provided the principal is paid, is deemed rejected when the debtor fails to pay the debt,

and the creditor was constrained to sue for collection thereof. (*Gamboa v. Gonzales*, 17 *Phil.* 381).

Art. 1321. The person making the offer may fix the time, place, and manner of acceptance, all of which must be complied with.

COMMENT:

(1) Things that May Be Fixed by the Offerer

- (a) the time
- (b) the place
- (c) the manner of acceptance

Any act contrary to the prescribed terms really constitutes a counter-offer or counter-proposal.

(2) Auction Sale

The rule stated in this Article applies also to an *auction* sale, whether it be a public or a private one. (*Leoquinco v. Postal Savings Bank*, 47 *Phil.* 772).

(3) Contract to Purchase

**Consolidated Mills, Inc. v.
Reparations Commission
76 SCRA 18**

A “contract to purchase” which does not give specific description of the objects to be purchased nor the price nor the rate of exchange to be used is a mere preliminary agreement.

(4) Case

**Douglas Millares and Rogelio Lagda v. NLRC,
Trans-Global Maritime Agency, Inc., & Esso
International Shipping Co., Ltd.
GR 110524, Jul. 29, 2002**

The Civil Code has always recognized, and continues to recognize, the validity and propriety of contracts and obligations

with a fixed or definite period, and imposes no restraints on the freedom of parties to fix the duration of a contract, whatever its object, be it specific, goods or services, except the general admonition against stipulations contrary to law, morals, good customs, public order, or public policy.

Under the Civil Code, therefore, and as a general proposition, fixed-term employment contracts are not limited, as they are under the present Labor Code, to those by nature seasonal or for specific projects with pre-determined dates of completion; they also include those to which the parties by free choice have assigned a specific date of termination.

[NOTE: Some familiar examples may be cited of employment contract which may be neither for seasonal work nor for specific projects, but to which a fixed term is an essential and natural appurtenance: overseas employment contracts, for one, to which, whatever the nature of the engagement, the concept of regular employment with all that it implies does not appear ever to have been applied. (*Millares, et al. v. NLRC, etc., supra*).]

[NOTE: Art. 280 of the Labor Code notwithstanding, also appointments to the positions of dean, assistant dean, college secretary, principal, and other administrative officers in educational institutions, which are by practice or tradition rotated among the faculty members, and where fixed terms are a necessity without which no reasonable rotation would be possible. Similarly, despite the provisions of Art. 280, Policy Instructions 8 of the Minister (Secretary) of Labor implicitly recognize that certain company officials may be elected for what would amount to fix periods, at the expiration of which they would have to stand down, in providing that these officials, may lose their jobs as president, executive vice-president or vice-president, etc. because the stockholders or the board of directors for one reason or another did not reelect them. (*Millares, et al. v. NLRC, etc., supra*).].

Art. 1322. An offer made through an agent is accepted from the time acceptance is communicated to him.

COMMENT:**(1) Acceptance of an Offer Made Thru an Agent**

- (a) The Article applies when BOTH the *offer* and the *acceptance* are made thru an AGENT (who is an *extension* of the personality of the *principal*. (*Art. 1910, par. 4, Civil Code*).
- (b) Any other intermediary (who is not an agent, with power to bind) is merely a sort of messenger, who must *communicate* to the person who sends him; otherwise, there is as yet no meeting of the minds.

(2) Query

Suppose the principal himself made the offer, and acceptance is communicated to the agent, would the Article apply? In other words, would there already be a meeting of the minds?

ANS.: It is submitted that as a general rule, there would as yet be no meeting of the minds, for the agent may be an ordinary one, not authorized to receive the acceptance for the PARTICULAR transaction. However, if the agent was expressly authorized to receive the acceptance, or if the offeree had been told that acceptance could be made direct with the agent, who would then be given freedom to act or to proceed, there can be a meeting of the minds and a perfection of the contract.

Art. 1323. An offer becomes ineffective upon the death, civil interdiction, insanity, or insolvency of either party before acceptance is conveyed.

COMMENT:**(1) When Offer Becomes Ineffective**

Art. 1323 gives 4 instances when the offer becomes ineffective.

(2) Example

A makes an offer to B on Jan. 1. B makes known his acceptance in a letter received at the house of A on Jan. 5. However, on Jan. 4, A had died. Here, the offer is ineffective because there was no meeting of the minds.

(3) Another Example

A makes an offer to B on Jan. 1. B writes a letter on Jan. 3, accepting the offer. This letter is received by A on Jan. 5. But on Jan. 4, B had died. Here the offer is also ineffective, because there was no meeting of the minds.

(NOTE: If one of the parties at the time of making the offer OR the acceptance was already insane, it may be said that there is a meeting of the minds, in a sense, because the contract is not void, but merely VOIDABLE, that is, it is valid until annulled.)

(4) Other Instances

There are *other* instances when the offer becomes ineffective, namely:

- (a) When the offeree expressly or impliedly rejects the offer.
- (b) When the offer is accepted with a qualification or condition (for here, there would merely arise a counter-offer).
- (c) When before acceptance is communicated, the subject matter has become *illegal* or *impossible*.
- (d) When the period of time given to the offeree within which he must signify his acceptance has already lapsed.
- (e) When the offer is revoked in due time (that is, before the offeror has learned of its acceptance by the offeree). (*See Laudico v. Arias, 43 Phil. 270*).

Art. 1324. When the offerer has allowed the offeree certain period to accept, the offer may be withdrawn at any time before acceptance by communicating such withdrawal, except when the option is founded upon a consideration, as something paid or promised.

COMMENT:**(1) General Rule on Options**

If the offerer has allowed the offeree a certain period to accept, the offer may be withdrawn at any time *before* accept-

ance (or the thing being offered) by communicating such withdrawal.

Example:

B, interested in a particular car at a car exchange company, asked *S* for the price. *S* said: "P3,500,000." *B* however could not make up his mind whether to buy or not. So *S* told *B*, "*B*, I'll give you a week to make up your mind. In the meantime, I will reserve this car for you." Before the week is over, can *S* withdraw the offer to sell the car for P3,500,000?

ANS.: Yes, provided *B* has *not* yet signified his acceptance of the offer to sell, that is, *B* has *not* yet bought the car, and provided that *S* communicates such withdrawal to *B*. Thus, *S* may, without liability to *B*, sell to another.

Another Example:

BAR

A offered to sell his house and lot for P10M to *B*, who was interested in buying the same. In his letter to *B*, *A* stated that he was giving *B* a period of one month within which to raise the amount, and that as soon as *B* is ready, they will sign the deed of sale. One week before the expiration of the one-month period, *A* went to *B*, and told him that he is no longer willing to sell the property unless the price is increased to P15M. May *B* compel *A* to accept the P10M first offered, and execute the sale? Reasons.

ANS.: No, because here the promise to sell (or the option granted *B* to buy) had *no* cause or consideration *distinct* from the selling price. (*Arts. 1479 and 1324, Civil Code; See Mendoza, et al. v. Comple, L-19311, Oct. 29, 1965*).

Cronico v. J.M. Tuason & Co., Inc. **78 SCRA 331**

To be binding on the person who made a *unilateral* promise, the promise must be supported by a cause or consideration distinct from the price.

(2) Exception

When the option is founded upon a consideration as something paid or promised.

Example: If, in the preceding example, *S* had been given P20,000 by *B* in consideration for the option, *S* cannot withdraw the offer to sell *until after* the expiration of the one-week period.

(3) ‘Option’ Defined

It is a contract granting a person the privilege to buy or not to buy certain objects at any time within the agreed period at a fixed price. The contract of option is a separate and distinct contract from the contract which the parties may enter into upon the consummation of the contract. Therefore, an option must have *its own cause* or consideration (*Enriquez de la Cavada v. Diaz*, 37 Phil. 982), a cause distinct from the selling price itself. (See *Millar v. Nadres*, 74 Phil. 307). Of course, the consideration may be *pure liberality*.

(4) Perfection of an Option

Since an option is by itself a contract, it is not perfected unless there is a meeting of the minds on the option. Thus, the *offer to grant an option, even if* founded on a distinct cause or consideration, may itself be withdrawn *before the acceptance of the offer of an option*.

Example:

In the preceding example under comment No. (1), if *S* had offered to grant *B* a week’s time if *B* would give P20,000 may *S* still withdraw the offer of option before *B* signifies his acceptance thereof?

ANS.: Yes, because here the option does *not* yet exist.

(NOTE: When the law therefore says “except when the option is founded upon a consideration, as something paid or promised,” the word “option” here refers to a “perfected contract of *option*,” that is, the option already exists.)

[NOTE: There is therefore a difference between *acceptance of the offer of option (which results in the contract of option)*, and *acceptance of the object being offered for sale or acceptance of the offer of sale (which results in the contract of sale)*.]

Atkins, Kroll, and Co. v. Cua Hian Tek
L-9871, Jan. 31, 1958

FACTS: On Sept. 13, 1951, Atkins, Kroll and Co., Incorporated offered to sell to B. Cua Hian Tek 1000 cartons of sardines subject to reply by Sept. 23, 1951. The respondent offeree *accepted* the offer unconditionally and delivered his letter of acceptance on Sept. 21, 1951. In view however of the shortage of the catch of sardines by the California packers, Atkins, Kroll, and Co. failed to deliver the commodities it had offered for sale. Offeree now claims that acceptance of the offer only created an option to buy which, lacking consideration distinct from the price, had *no* obligatory force.

HELD: The offerer is wrong. The argument is untenable, because acceptance of the offer to sell by showing the intention to buy for a price certain *creates* bilateral contract to sell and buy. The offeree, upon acceptance, *ipso facto* assumes the obligation of a buyer, so much so that he can be sued should he back out after acceptance, by either refusing to get the thing sold or refusing to receive the price agreed upon. Upon the other hand, the offerer would be liable for damages, if he fails to deliver the thing he had offered for sale.

Even granting that an option is granted which is *not* binding for lack of consideration, the authorities hold that “if the option is given without a consideration, it is a mere offer of a contract of sale, which is not binding until accepted.” If however acceptance (of the sale, as distinguished from the acceptance merely of the option) is made before a withdrawal, it constitutes a *binding contract of sale*, even if the option was not supported by a sufficient consideration.” (7 *Corpus Juris Secundum*, p. 652).

(NOTE: The rule in the instant case reverses the principle held in *Southwestern Sugar & Molasses Co. v. Atlantic Gulf & Pacific Co.*, 97 *Phil.* 249.)

Art. 1325. Unless it appears otherwise, business advertisements of things for sale are not definite offers, but mere invitations to make an offer.

COMMENT:

Business Advertisements

Are business advertisements of things for sale *definite* offers?

ANS.: It depends:

- (a) If appears to be a definite offer containing all the specific particulars needed in a contract, it really is a definite offer.

Example:

“For Sale: 900 sq. meter lot with a brand new 1-1/2 storey house at 1445 Perdigon, Paco, Manila for P10 million cash.” This is a definite offer, from which the advertiser cannot back out, *once it is accepted by another.*

- (b) If important details are left out, the advertisement is not a definite offer, but a *mere invitation to make an offer.*

Example:

“For Sale: 1000 sq. meter lots at P100 million to P150 million a lot at South Forbes Park Tel. 88-00-00.” This is clearly merely an invitation to make an offer, which the advertiser is free to accept or to reject.

Art. 1326. Advertisements for bidders are simply invitations to make proposals, and the advertiser is not bound to accept the highest or lowest bidder, unless the contrary appears.

COMMENT:

(1) Advertisement for Bidders

Note that as a *general rule*, the advertiser is NOT bound to accept the highest or lowest bidder.

(2) Problem

In an advertisement for bidders, there was NO reservation by the advertiser that he could reject any and all bids. Now then, is he still given the right to reject even the highest *bidder* (as when the offer is to sell) or the lowest bidder (as when his offer is to buy)?

ANS.: Yes, for the rule is that “the advertiser is *not* bound to accept the highest or lowest bidder, unless the contrary appears.” (*Art. 1326, Civil Code*).

(3) Acceptance of a Bid

The mere determination of a public official or board to accept the proposal of a bidder does NOT constitute a contract; the decision must be communicated to the bidder. (*Jalandoni v. National Resettlement & Rehabilitation Adm., et al., L-15198, May 30, 1960*).

(4) Bidder Submits to Conditions

Anybody participating in the bidding at a public auction is understood to have submitted himself to all the conditions set forth at such sale. (*Leoquinco v. Postal Savings Bank, 47 Phil. 772*).

**Leoquinco v. Postal Savings Bank
47 Phil. 772**

FACTS: The Board of Directors of the Postal Savings Bank authorized the sale at public auction of a parcel of land it owned at Navotas, Rizal. The Board expressly reserved “the right to reject any and all bids.” The auction notice also contained such reservation. Leoquinco offered the highest bid (P27,000) but this was rejected by the Board. Leoquinco then sued to compel the Bank to execute and deliver the deed of sale, with damages.

HELD: The action will not prosper, for there really was no sale. By participating in the auction and offering his bid, he voluntarily submitted to the terms and conditions of the auction sale announced in the notice, and he therefore *clearly* acknowledged the right of the Board to reject any and all bids.

The owner of property offered for sale at a public or private auction has the right to prescribe the *manner, conditions, and terms* of such sale. He may even provide that all of the purchase price shall be paid at the time of sale, or any portion thereof, or that time will be given for the payment. (*Blossom v. Milwaukee and Chicago Railroad Co.*, 3 Wallace U.S. 196). The conditions are binding upon the purchaser, *whether he knew them or not*.

(5) Problem

In an advertisement for bidders, it was stated that the award should be given not to the “lowest bidder,” not to the “lowest responsible bidder,” but to the “lowest and best bidder.” Distinguish the terms used.

ANS.: The “lowest bidder” is he who offers the lowest price (as in the case of a purchase by the bidder, or a contract for work by the bidder). The term “lowest responsible bidder” includes not only financial ability, but also the skill and capacity necessary to complete the job for which the bidder would become answerable. The expression “*lowest and best bidder*” is even wider and includes not only financial responsibility, skill, and capacity, BUT ALSO the reputation of the bidders for dealing fairly and honestly with the government, their mechanical facilities, and business organization tending to show dispatch in their work and harmonious relations with the government, the magnitude and urgency of the job, the kind and quality of materials to be used, and other factors as to which a bidder may offer greater advantages than another. (*See Borromeo v. City of Manila*, 62 Phil. 512).

(6) Bids at Execution Sales

In an execution sale of properties attached for the payment of debts, it is generally understood that the property should be given to the *highest bidder*. In the case of the execution sale of the extrajudicial family home whose value is believed to be more than the P30,000 or P20,000 fixed by law, the lowest bid that can be accepted is one that exceeds such values; therefore, the highest bid thereon must necessarily be higher than said values. (*See Art. 249, Civil Code*).

Art. 1327. The following cannot give consent to a contract:

- (1) Unemancipated minors;**
- (2) Insane or demented persons, and deaf-mutes who do not know how to write.**

COMMENT:

(1) Two Classes of Voidable Contracts

- (a) Those where one party is *incapacitated to give consent*. (*Art. 1327, Civil Code*).
- (b) Those where the consent of one party has been *vitiating* (such as by error, fraud, violence, intimidation, and undue influence). (*Arts. 1330-1334, Civil Code*).

[*NOTE:* These contracts in general are valid until annulled; however, annulment cannot prosper when they have been ratified. (*See Art. 1390, Civil Code*).]

(2) Persons Incapacitated to Consent

- (a) Unemancipated minors.
- (b) Insane or demented persons (unless they acted during a lucid interval), drunks and those hypnotized. (*Art. 1328, Civil Code*).
- (c) Deaf-mutes who do *not* know how to write (and read).

[*NOTE:* If they know how to read, but do not know how to write, it is submitted that the contract is valid, for then they are capable of understanding, and therefore capacitated to give consent.)

(3) Unemancipated Minors

- (a) These are the minors who have *not* been emancipated by *marriage, attainment of the age of majority, or by parental or judicial authority*. (*Art. 1397, Civil Code*).

[*NOTE:* The State by virtue of the principle of *parents patriae* is obliged to minimize the risk to those who,

because of their *minority*, are as yet unable to take care of themselves fully. (*People v. Baylon*, L-35785, May 29, 1974). This prerogative of *parens patriae* is inherent in the supreme power of every state. (*Cabanas v. Pilapil*, L-25843, Jul. 25, 1974).]

[NOTE: As between the mother and the uncle of a *minor*, the former is preferred to act as trustee of the proceeds of the insurance policy of the deceased father in the absence of evidence indicating that said mother is incompetent. (*Ibid.*).]

- (b) In general, the contracts which they enter into are VOID-ABLE *unless*:
- 1) Upon reaching the age of majority, they ratify the same. (*Ibanez v. Rodriguez*, 47 Phil. 554).
 - 2) They were entered into *thru* a guardian, and the *court* having jurisdiction had *approved* the same. (*Roa v. Roa*, 52 Phil. 879).
 - 3) They were contracts of life insurance in favor of their parents, spouse, children, brothers, sisters, and provided, furthermore, that the minor is 18 years old or above. (*See Act No. 3870*).
 - 4) They were in the form of savings account in the *Postal Savings Bank*, provided furthermore that the minor was at least *seven* years old. (*See Sec. 2007, Rev. Adm. Code*).
 - 5) They were contracts for necessities such as *food*, but here the people who are legally bound to give them support should pay therefor. (*See Arts. 1489, 2164, Civil Code*).
 - 6) They were contracts where the minor misrepresented his age, and pretended to be one of major age and is, thus, in ESTOPPEL. (*Marcelo v. Espiritu*, 37 Phil. 37; *Sia Suan v. Alcantara*, 47 O.G. 4561; and *Hermosa v. Zobel*, L-11835, Oct. 30, 1958). It is, however, essential here that the other party must have been MISLED. (*Bambalan v. Maramba*, 51 Phil. 417).

- (c) *Married minors* can validly alienate or encumber *personal* property *without* parental consent, but in the case of *real* property or if they want to *borrow* money, they need such parental consent, without which the transaction is voidable. (*See Art. 399, Civil Code*).
- (d) If both parties to a contract are *minors*, the contract is unenforceable. (*Art. 1403, No. [3]* states that contracts “where *both* parties are incapable of giving consent to a contract” are UNENFORCEABLE.)

(4) Insane or Demented Persons (Unless They Acted During a Lucid Interval)

- (a) *Reason:* People who contract must know what they are entering into.
- (b) No proper declaration of insanity by the court is required, as long as it is shown that at the time of contracting, the person was really insane. (*18 Manresa 660*).
- (c) Even if a person *had already* been declared insane, this does *not* necessarily mean that at the time of contracting, said person was still insane. (*Dumaguin v. Reynolds, 48 O.G. 3887*).
- (d) Upon the other hand, if the contract was made *before* the declaration of insanity, the presumption is that he was still SANE at the time of contracting. He who alleged the insanity of another at the time of contracting is duty-bound to prove the same, otherwise, the latter’s capacity must be presumed. (*Carillo v. Jaoco, 45 Phil. 597*).

(5) Deaf-Mutes Who Do Not Know How to Write (and Read)

- (a) *Formerly*, a deaf-mute was presumed to be an idiot. (*See Director of Lands v. Abelardo, 54 Phil. 387*).
- (b) If a deaf-mute does not know how to *write* but he knows how to read, he should be considered capacitated.

(6) Persons Specially Disqualified

There are people who are SPECIALLY DISQUALIFIED in certain things. Here, the transaction is VOID because the right

itself is restricted, that is, the right is **WITHHELD**. (In the case of mere *legal incapacity*, the transaction is **VOIDABLE** because the right itself is *not* restricted, but merely its **EXERCISE**, that is, it can still be exercised but under certain conditions, such as when the parents of an unemancipated minor consent.)

(7) Examples of Persons Specially Disqualified

- (a) As a general rule, the *husband* and *wife* cannot sell to each other (*Art. 1490, Civil Code*), nor can they *donate* to each other. (*Art. 134, Civil Code*). Violations are considered **VOID** contracts, but only those prejudiced can assail the validity of the transaction. (*Harding v. Commercial Union Assurance Co.*, 38 *Phil.* 464 and *Cook v. McMicking*, 27 *Phil.* 10).
- (b) *Insolvents* before they are discharged cannot, for example, make payments. (*See Insolvency Law, Sec. 24*).
- (c) Persons disqualified because of *fiduciary relationship*, such as the guardian, who is not allowed to purchase the property of his ward; or judges, with reference to the property under litigation. (*Art. 1491, Civil Code*).
- (d) Contracts entered into with *non-Christians* (except contracts of personal service and the *barter* or *sale of personal property*) are **VOID** unless approved by the governor or his representative. (*Secs. 146 and 147, Adm. Code of Mindanao and Sulu*). *Reason*: To prevent their ignorance from being preyed upon. (*Porken v. Yatco*, 70 *Phil.* 161). It is understood, however, that the rule applies only to those entered into *within* the territory covered by the former department of Mindanao and Sulu. (*See City of Manila v. Narvasa*, L-8545, Dec. 29, 1955; *See also Mangayao v. De Guzman*, L-24787, Feb. 22, 1974).

Art. 1328. Contracts entered into during a lucid interval are valid. Contracts agreed to in a state of drunkenness or during a hypnotic spell are voidable.

COMMENT:**(1) Some Voidable Contracts by Reason of Incapacity**

The voidable contracts referred to in this Article are those entered into by:

- (a) Insane or demented persons (unless they acted during a lucid interval);
- (b) Those in the state of *drunkenness* (which temporarily results in complete loss of understanding, and may therefore be equivalent to temporary insanity). (TS, Nov. 6, 1858 and TS, Apr. 21, 1911);
- (c) Those entered into during a *hypnotic spell* (induced by drugs, or by *deliberate* or *unintentional* hypnotism) or while a person walks during his sleep, *somnambulism*, for in these cases, a person is incapable of intelligent consent. (*See 8 Manresa 660-661*).

(2) Lucid Intervals

Even if a person has already been judicially declared insane, and is actually now under guardianship, he may still enter into a valid contract, provided that it can be shown that at the time of contracting, he was in a *lucid interval*. Of course here, he is already presumed insane, and therefore the sanity must be proved. (*Dumaguin v. Reynolds, et al., 92 Phil. 66*).

(3) Insanity in Some Things, But Sanity in Other Things

There are countless instances of individuals who are mentally deranged, and have obsessions and delusions regarding certain subjects and situations and yet are still mentally sound in other respects. (*Dumaguin v. Reynolds, et al., 92 Phil. 66*).

Art. 1329. The incapacity declared in Article 1327 is subject to the modifications determined by law, and is understood to be without prejudice to special disqualification established in the laws.

COMMENT:**(1) Modifications Re Incapacity**

- (a) For a discussion of “special disqualifications” see comment Nos. 7 and 8 under Art. 1327.
- (b) Regarding contracts entered into by non-Christians, *approval* by the officials concerned is required *even* if BOTH parties are non-Christians, because both imposition and fraud are still possible in this case. (*Madale, et al. v. Raya, et al.*, 92 *Phil.* 558).

(2) Incompetents Under the Rules of Court

Under the Rules of Court, the following are considered *incompetents*, and may be *placed under guardianship*:

- (a) those under civil interdiction
- (b) hospitalized lepers
- (c) prodigals (spendthrifts)
- (d) deaf and dumb who are unable to read and write
- (e) those of unsound mind *even though* they have lucid intervals
- (f) those who by reason of *age, disease, weak mind, and other similar causes, cannot without outside aid*, take care of themselves and manage their property, becoming thereby an easy prey for deceit and exploitation. (*Sec. 2, Rule 92, Revised Rules of Court*).

(3) Problem

If a *hospitalized leper* or a *very old man* has not been placed under guardianship, may he still enter into a binding contract?

ANS.: Yes, because he would still be presumed capacitated to enter into a contract (although classified as an “incompetent”). Of course, if it can be shown that *intelligent consent* was absent, the contract can be considered VOIDABLE. (*See Cui, et al. v. Cui, et al.*, 100 *Phil.* 913).

(**NOTE:** There is, therefore, a difference between an “incompetent” under the Rules of Court, and a person “who cannot give consent to a contract” under the Civil Code.)

Art. 1330. A contract where consent is given through mistake, violence, intimidation, undue influence, or fraud is voidable.

COMMENT:

(1) Causes of Vitiating Consent

Aside from “incapacity to give consent,” the following are *causes of vitiated consent*: (They are also referred to as “*vices of consent*.”)

- (a) mistake (or error)
- (b) fraud (or deceit)
- (c) violence
- (d) intimidation
- (e) undue influence

[*NOTE: Mistake and fraud affect the INTELLECT (which is the faculty in the mind of man, the proper object of which is the TRUTH. They thus affect COGNITION.) Cognition must be intelligent.*]

[*NOTE: Violence, intimidation, and undue influence affect the WILL (which is the faculty in the mind of man, the proper object of which is the GOOD. They thus affect VOLITION.) Volition must be free.*]

[*NOTE: Mistake and fraud result in defects of the intellect; the others result in defects of the will.*]

(2) Nature of a Voidable Contract

A voidable contract is *binding and valid*, unless annulled by a proper action in court. It is, however, susceptible of ratification before annulment. (*Art. 1390, Civil Code*). Annulment may be had even if there be NO damage to the contracting parties. (*Art. 1390, 1st paragraph, Civil Code*).

(3) Clear and Convincing Evidence on the Vice of Consent

There must be *clear and convincing* evidence of the presence of vitiated consent. Mere preponderance of evidence on this matter is not sufficient. (*Centenera v. Palicio, 29 Phil. 470*).

Art. 1331. In order that mistake may invalidate consent, it should refer to the substance of the thing which is the object of the contract, or to those conditions which have principally moved one or both parties to enter into the contract.

Mistake as to the identity or qualifications of one of the parties will vitiate consent only when such identity or qualifications have been the principal cause of the contract.

A simple mistake of account shall give rise to its correction.

COMMENT:

(1) ‘Mistake’ or ‘Error’ Defined

It is a false belief about something.

(2) Requisites for Mistake to Vitate Consent

- (a) The error must be substantial regarding:
 - 1) the object of the contract
 - 2) the *conditions* which *principally moved or induced* one of the parties (error in *quality* or in *quantity* – error in *qualitate* or in *quantitate*).
 - 3) *identity or qualifications* (error in *personae*), but only if such was the *principal cause* of the contract.
- (b) The error must be *excusable* (not caused by negligence).
- (c) The error must be a *mistake of fact*, and *not of law*. (*Luna v. Linatoc*, 74 Phil. 15).

(3) Substantial Error

The error is substantial if because of it, the party gave his consent. Therefore, if a party would still have entered into the contract even if he had known of the error, the error is NOT substantial. (8 *Manresa* 666).

(4) Error Regarding the Object of the Contract

Example: A person signed a contract of sale thinking it was only a contract of loan. (*Dumasag v. Modelo*, 34 Phil. 252; *Transporte v. Beltran*, [C.A] 51 O.G. 1434, March, 1955].)

(5) Error Regarding the Conditions That Principally Induced the Party to Enter Into the Contract

Example: Error in knowledge about the *true boundaries* of a parcel of land offered for sale. (*Mariano v. Linton*, 45 Phil. 653).

(NOTE: Error as to personal motive does *not* vitiate consent.

Example: a boy buys an engagement ring in the false belief that his girl loves him.)

**Rural Bank of Caloocan v. Court of Appeals
L-32116, Apr. 21, 1981**

FACTS: Thru alleged fraud committed by a third party (the Valencia spouses), Maxima Castro found herself indebted to a Rural Bank for a *total* debt of P6,000 (P3,000.00 was what she intended to borrow; the Valencias added another P3,000.00 for themselves, with Castro signing the promissory note as co-maker). *Issue:* For how much is Castro liable?

HELD: Only for P3,000. The contract can be partially annulled insofar as Castro is concerned, not because of fraud (neither party — the Bank nor Castro had committed fraud), but because of *mutual error* caused by the fraud attributable to the Valencias. The mortgage over Castro's lot is *reduced* insofar as it exceeds Castro's personal loan.

(6) Error in Quality

Examples: A person buys a fountain pen thinking it to be made of solid gold when as a matter of fact, it is merely gold-plated; a person buys a CD record thinking it to be Stateside, but it turns out to be merely a local imitation, a pirated one.

(7) Error in Quantity

Example: A person desiring to buy land consisting of 100 hectares discovers that the land has only 60 hectares. (*See Asian v. Jalandoni*, 45 Phil. 296).

[NOTE: A simple mistake as to account, caused for example by wrong arithmetical computation, would *ordinarily* give rise merely to *correction*, and *not annulment* of the contract.

Example:

If A bought 10 notebooks at P5.20 each, and mistakenly, the contract showed a total value of P55 instead of P52, this is merely an error in computation, an error in account, and will therefore require only correction. (8 *Manresa* 669-670). But even here, had the seller sold the notebooks only because he thought he would get P55, an amount he needed badly (and would not have sold had a lesser price been offered), this would be not a mere error of account, but truly a substantial error in quantity.]

[Note, therefore, the difference between *error in quantity* and *error in account*. (He who alleges must prove the same). (*Gutierrez Hnos. v. Oria Hnos.*, 30 *Phil.* 491).]

(8) Error in Identity or in Qualifications

This vitiates consent only when such *identity* or *qualifications* have been the *principal cause* of the contract.

Examples: Hiring of a pre-bar reviewer, a *particular* singer for a concert, contracts involving partnership, agency, deposit — since these require trust and confidence. (See 8 *Manresa* 667-669).

(NOTE: If *any* painter or singer would do, error as to the identity of the particular painter or singer hired would be immaterial.)

(9) Excusable Error

The error does not vitiate consent if the party in error was negligent, or if having had an opportunity to ascertain the truth, he did not do so. (See, however, Art. 1332, *Civil Code*). Moreover, there is no mistake if the party alleging it knew the *doubt, contingency or risk* affecting the object of the contract. (Art. 1333, *Civil Code*). Error as to how much profit a person can make because of the transaction, cannot annul the contract because in many cases, this is merely speculative. (See *TS, Jan. 15, 1910*).

(10) Error of Fact, Not of Law

The error must be one of fact, not of law. This is because ignorance of the law does not excuse anyone from compliance therewith. (Art. 3, *Civil Code* and 8 *Manresa* 646). Thus, if one

sells property in the false belief that conjugal property could be partitioned during a marriage, the sale cannot be annulled. (*Luna, et al. v. Linatoc*, 74 Phil. 15). Error of law, however, on a doubtful or difficult question can exist together with good faith. (*Art. 526, Civil Code and Kasilag v. Rodriguez*, 69 Phil. 217).

[NOTE: “Mutual error as to the legal effect of an agreement when the real purpose of the parties is frustrated, may vitiate consent.” (*Art. 1334, Civil Code*). “Legal effect” here refers to the rights of the parties as stated in the legal provisions.]

Art. 1332. When one of the parties is unable to read, or if the contract is in a language not understood by him, and mistake or fraud is alleged, the person enforcing the contract must show that the terms thereof have been fully explained to the former.

COMMENT:

(1) Rule in Case of Inability to Read or Understand

Reason for the Article:

“This rule is especially necessary in the Philippines where unfortunately there is still a fairly large number of illiterates, and where documents are usually drawn up in English or Spanish.” (*Report of the Code Commission*, p. 136).

(2) Presumption

The natural presumption, of course, is that one always acts with due care and signs with full knowledge of all the contents of a document. And this is true even if the mind of the party signing was *confused* at the time of signing, as long as he still knew what he was doing. He, thus, cannot repudiate the transaction. (*Abaya v. Standard Vacuum Oil Co.*, L-9511, Aug. 30, 1957; *Javier v. Javier*, 7 Phil. 261; and *Tan Tua v. Jy Liao Sontua*, 56 Phil. 70).

(3) When Presumption Does Not Apply

The presumption referred to cannot apply in the cases contemplated under this Article:

- (a) when one of the parties is *unable to read* (including a blind person) (*Transporte v. Beltran*, [C.A.] 51 O.G. 1434);
- (b) or if the contract is in a language *not understood* by one of the parties. (*Art. 1332, Civil Code*).

In BOTH cases, “the *person* enforcing the contract *must show* that the terms thereof have been fully explained to the former.” (*Art. 1332, Civil Code and Ayola v. Valderrama Lumber Manufacturers Co., Inc.*, [C.A.] 49 O.G. 980).

(4) Cases

Ayola v. Valderrama Lumber Manufacturers Co., Inc. (C.A.) 49 O.G. 980

FACTS: Ayola, an illiterate person, signed a document in the belief that it was a receipt of a part payment, when as a matter of fact it was something else. The opposite party (the Lumber Company) contended however, that what was important is that Ayola had signed it, and therefore the same is binding on him. It should be noted that in Ayola’s pleadings he expressly said he had signed the voucher “without knowing its contents which had not been explained to him.” *Issue:* Who had the burden of proving that Ayola had fully understood the contents of the document?

HELD: The Lumber Company had the burden of proving that Ayola had fully understood the document’s contents, because his plea was equivalent to an allegation of mistake or fraud. Having failed to do so, the presumption of mistake (if not fraud) stands un rebutted and controlling.

Transporte v. Beltran (C.A.) 51 O.G. 1434

FACTS: Bonificia Transporte, blind since 1930, and already 70 years, affixed on Aug. 23, 1945 her thumbmark to a deed of sale because she thought it was a deed of mortgage. The sale was in favor of her son-in-law and was done thru a public instrument. *Issue:* May the deed of sale be annulled?

HELD: Yes, the deed of sale can be annulled because of failure on the part of the son-in-law to prove that he did not take advantage of his favored situation as a son-in-law to enrich himself at the expense of an unfortunate relative. The fact that the deed was in a public instrument is of no consequence, for even here, courts are given a wide latitude in determining what actually occurred, considering the age, physical infirmity, intelligence, and relationship of the parties.

Art. 1333. There is no mistake if the party alleging it knew the doubt, contingency or risk affecting the object of the contract.

COMMENT:

(1) Knowledge of Doubt or Risk Does Not Vitiate Consent

It is to be assumed here that the party was willing to take the risk. This is particularly true in contracts which are evidently *aleatory* in nature.

(2) Example

A bought a fountain pen which was represented as possibly being able to write even underwater. A also knew that the pen's ability was questionable, and yet A bought said pen. Here, A cannot allege mistake since he knew beforehand of the doubt, risk, or contingency affecting the object of the contract.

(3) Mistake Caused by Inexcusable Negligence

If mistake is caused by inexcusable negligence, the contract cannot be annulled.

Art. 1334. Mutual error as to the legal effect of an agreement when the real purpose of the parties is frustrated, may vitiate consent.

COMMENT:

(1) Requisites for Mutual Error to Vitiate Consent

- (a) There must be *mutual* error.

- (b) The error must refer to the *legal* effect of the agreement.
- (c) The real purpose of the parties is *frustrated*.

Example: A and B entered into a contract, which they intended should result in a co-ownership between them, but which turned out later to be a mortgage, as a result of their mutual error as to the legal effect of the agreement. Here the contract is voidable.

(2) Reason for the Article

“Mistake of law does not generally vitiate consent, BUT when there is a mistake on a doubtful question of law, or on the construction or application of law, this is analogous to a mistake of fact, and the maxim ‘*ignorantia legis neminem excusat*’ should have no proper application. When even the highest courts are sometimes divided upon difficult legal questions, and when one-half of the lawyers in all controversies on a legal question are wrong, why should a layman be held accountable for his honest mistake on a doubtful legal issue?” (*Report of the Code Commission*, p. 136).

(3) Distinguished from the Remedy of Reformation

This Article must be distinguished from Art. 1361 where the remedy is *reformation*, not annulment. Thus, Art. 1361 of the Civil Code reads: “When a mutual mistake of the parties causes the failure of the instrument to *disclose their real agreement*, said instrument may be reformed.”

(NOTE: Under Art. 1361, the real agreement is *not disclosed*; in Art. 1334, the error is as to the *legal effect* of the agreement. *Example:* A and B agreed on a sale, but as written, the document shows a mortgage. Here, there was a meeting of the minds, but the instrument does not show the real intention. Hence, the remedy is *reformation*. If on the other hand, both agreed on a sale, and as *written*, the document is one of sale, but both parties thought erroneously that it had the same effects as a *mortgage*, there is no meeting of the minds, and the remedy is annulment.)

Art. 1335. There is violence when in order to wrest consent, serious or irresistible force is employed.

There is intimidation when one of the contracting parties is compelled by a reasonable and well-grounded fear of an imminent and grave evil upon his person or property, or upon the person or property of his spouse, descendants or ascendants, to give his consent.

To determine the degree of the intimidation, the age, sex and condition of the person shall be borne in mind.

A threat to enforce one's claim through competent authority, if the claim is just or legal, does not vitiate consent.

COMMENT:

(1) Violence and Intimidation

Violence refers to physical coercion; intimidation, to moral coercion.

Example: If a person signs a contract only because a gun is pointed at him, this is *intimidation* because he is afraid he would be killed. But if he signs because his left hand is being twisted painfully, this is violence or force.

(2) Requisites for Violence to Vitate Consent

- (a) Employment of *serious* or *irresistible* force;
- (b) It must have been the reason why the contract was entered into.

(3) Requisites for Intimidation to Vitate Consent

- (a) *reasonable* and *well-grounded* fear
- (b) of an *imminent* and *grave* evil
- (c) upon his *person*, *property*, or upon the *person* or *property* of his *spouse*, *descendants*, or *ascendants*
- (d) it must have been the *reason* why the contract was entered into
- (e) the threat must be of an *unjust act*, an *actionable wrong*. (Therefore, a threat to enforce *one's claim* thru *competent authority*, if the claim is *just* or *legal*, does not vitiate consent.) (Art. 1335, last paragraph). A threat to prosecute is not considered as intimidation. (*P. P. Agustin v. Del Rey*,

56 Phil. 512; *Sotto v. Mariano*, [C.A.] 36 O.G. 1056.) But, of course, an agreement not to prosecute on account of a crime is against public policy. (*Arroyo v. Berwin*, 36 Phil. 386 and *Hibberd v. Rhode*, 32 Phil. 476).

(4) Reasonable and Well-Founded Fear

- (a) Whether the fear is reasonable and well-grounded or not depends upon many circumstances, including the *age*, *condition*, and *sex* of the person concerned. (*Art. 1335, par. 3*).
- (b) A threat during the Japanese occupation to deliver the person to the Japanese military authorities would constitute intimidation (*Rodriguez v. De Leon*, 47 O.G. 6296), but not the mere fear that one may be so reported, in the absence of an actual threat. Hence, the courts have held that there was collective “duress” during the Japanese occupation, in the absence of an actual threat. (*Fernandez, et al. v. Brownell*, 51 O.G. 713 and *Phil. Trust Co. v. Luis Araneta*, 83 Phil. 132). Mere knowledge that severe penalties might be imposed is not enough. (*Valdeabella v. Marquez*, [C.A.] 48 O.G. 719). Indeed, in order to cause the nullification of contracts executed during the Japanese occupation, the duress or intimidation must be more than the “general feeling of fear” on the part of the occupied over the show of might by the occupant. (*Lacson, et al. v. Granada, et al.*, L-12035, Mar. 29, 1961, citing *People v. Quillyo*, L-2313, Jan. 10, 1951 and other cases).
- (c) The fear is reasonable and well-grounded when those who threaten have power, and when maltreatment has accompanied the threat. (*Derequito v. Dolutan*, [C.A.] 45 O.G. 1351).
- (d) The fear is *not* well-grounded when the person who threatened for instance to initiate *expropriation* proceedings by the government, if the other party would not consent, is in no position to accomplish the same, considering his position as mere foreman in the Bureau of Public Works. (*Alarcon v. Kasilag*, [C.A.] 40 O.G. [Sup. 11], p. 203). The same thing may be said of a vague threat to prevent an alien from engaging in business in the Philippines. (*Berg v. Nat. City Bank*, L-9312, Oct. 31, 1957).

(5) Imminent and Grave Evil

This again depends on the circumstances, particularly, the age, sex, or condition of the person threatened. Thus, exposure of a public official's nightly indiscretions or immoralities is more serious to him than the threat is to a common day laborer.

(6) Nature of the Threat on Person and Property of the Persons Enumerated

- (a) It is believed that threat to honor, chastity, and dignity may be classified under threat to "person."
- (b) *Query*: Is the enumeration of persons exclusive in that a threat, for example, to the life of *one's fiancée*, is not considered intimidation? It is submitted that the provision must be liberally interpreted for indeed consent here is vitiated just the same.

(7) Reason for Entering Into the Contract

If the person concerned would have entered into the contract even without the presence of intimidation, it is clear that the contract should be considered valid, for the consent certainly cannot be considered vitiated.

(8) Threat of an Unjust Act or an Actionable Wrong

- (a) If a man marries a girl who threatened to report him to the Courts for immorality, and thus prevent his admission to the bar, the marriage *cannot* be annulled on the ground of intimidation because here the girl had the legal right to do what she threatened. (*Ruiz v. Atienza*, O.G. Aug. 30, 1941, p. 1903).
- (b) A threat to prosecute unless the debtor signs a contract is not intimidation. (*Sotto v. Mariano*, [C.A.] 36 O.G. 1056).
- (c) If a debtor consents to pay under a threat of recourse to the courts, the expenses of litigation, he *cannot* maintain that his consent was vitiated; BUT it will be otherwise if, passing beyond the limits of his rights, a creditor has exacted from a debtor with these same *legal threats*, a *novation* of the contract or a *confession* of a larger indebtedness. (*Jal-*

buena v. Ledesma, 8 Phil. 601, citing *Adams v. Irving N. Bank*, 116 N.Y. 606, which holds that the threat of legal prosecution of a husband amounts to intimidation of his wife who is constrained thereby to become his *surety*.)

[NOTE: If however a wife does what she does, not because of fear, but because of common sense, fair play, and a sense of justice, and upon the advice of competent counsel, the contract is valid even if it was entered into reluctantly. (*Martinez v. Hongkong & Shanghai Bank*, 15 Phil. 253; see also *Tapis v. Carman and Elser*, 60 Phil. 956).]

- (d) The right to enforce one's claim thru competent authority must not by itself constitute an unlawful act. *Example*: A witness to a crime threatens to report the criminal to the police unless said criminal gives money to him. This is a clear case of blackmail.

(9) Cases

Tabacalera v. Collector L-9071, Jan. 31, 1957

FACTS: Tabacalera and Co. entered into a contract of guaranty, allegedly because the customs investigator threatened to prevent the sailing of its vessel unless the specific taxes and other charges on the imports were first paid. After the ship sailed, the Company, pursuant to the guaranty, made payment.

Issue: Was the contract valid?

HELD: Granting that the threat was made, still it was a justified and legal threat. Moreover, it should be noted that when the ship had sailed, the duress no longer existed and yet payment was still made. This evidently is a valid ratification of the promise.

Berg v. National City Bank L-9312, Oct. 31, 1957

FACTS: Berg signed a compromise agreement with the National City Bank because the bank had threatened to bring an action against him and his brother for non-payment, and to

refuse him any further credit facilities. *Issue*: Is the agreement valid?

HELD: Yes, because the threat of court action was proper within the realm of law as a means to enforce collection. The threat to cut off credit is also proper because the bank merely wants to protect its investment. The court quoted *Williston on Contracts*, Vol. 5, pp. 4500-4502: "One element of the early law of duress continued to exist, however its boundaries may be otherwise extended. The pressure must be wrongful, and not all pressure is wrongful. The law provides certain means for the enforcement of their claims by creditors. It is not duress to threaten to bring a civil action and to resort to remedies given by the contract is not such duress as to justify rescission of a transaction induced thereby, *even though there is no legal right to enforce the claim, provided the threat is made in good faith*; that is, in the belief that a possible cause of action exists. But if the threat is made with the consciousness that there is no real right of action, and the purpose of coercion, a payment or contract induced thereby is voidable. In the former case, it may be said that the threatened action is rightful; in the latter case, it is not."

(10) Reverential Fear

If a contract is signed merely because of "fear of displeasing persons to whom obedience and respect are due," the contract is still *valid*, for by itself reverential fear is not wrong.

Sabalvaro v. Erlanger & Galinger, Inc. **64 Phil. 588**

FACTS: Sabalvaro signed a contract allegedly because he was afraid he would be dismissed by his employer, should he refuse to sign. Was there intimidation if the threat of dismissal is not proved?

HELD: Since the threat of dismissal was not proved, it follows that the fear was unfounded; and if he were to allege that he feared incurring the displeasure of his employers, still reverential fear does not by itself serve as a ground for the annulment of a contract.

[NOTE: The same thing may be said of reverential fear in a client (*Turner v. Casabar*, 65 Phil. 490), in the absence of an actual threat.]

Art. 1336. Violence or intimidation shall annul the obligation, although it may have been employed by a third person who did not take part in the contract.

COMMENT:

Violence or Intimidation Caused by Third Person

Even if a third person exercised the violence or intimidation, the contract may be annulled. This is because the consent is still vitiated. (*De Asis v. Buenviaje*, [C.A.] 45 O.G. 317).

Art. 1337. There is undue influence when a person takes improper advantage of his power over the will of another, depriving the latter of a reasonable freedom of choice. The following circumstances shall be considered: the confidential, family, spiritual and other relations between the parties, or the fact that the person alleged to have been unduly influenced was suffering from mental weakness, or was ignorant or in financial distress.

COMMENT:

(1) Requisites for Undue Influence to Vitate Consent

- (a) *improper advantage*
- (b) *power over the will of another* (reflected for example in a superior bargaining power). (*See Martinez v. Hongkong and Shanghai Bank*, 15 Phil. 252).
- (c) *deprivation of the latter's will of a reasonable freedom of choice*

(The influence exerted must be of a kind that overpowers the mind as to destroy the party's free agency.) (*Coso v. Fernandez Deza*, 42 Phil. 596).

(2) Examples of Circumstances to be Considered

- (a) confidential, family, spiritual, and other relations between the parties
- (b) mental weakness
- (c) ignorance
- (d) financial distresss

[NOTE: To vitiate consent, the influence must be UNDUE. If the influence is DUE or ALLOWABLE, as when caused by solicitation, importunity, argument and persuasion, same is not prohibited by law, morals, or equity. (Martinez v. Hongkong and Shanghai Bank, 15 Phil. 252).]

**Cui, et al. v. Cui, et al.
100 Phil. 913**

FACTS: An 83-year-old father executed in favor of *one of his daughters, as well as a son*, a deed of sale. At the time of the sale, he had lived in the house of said daughter during the preceding month. (It was his habit to live with his children at their individual homes, one at a time.) The son, who was the only lawyer in the family, had been appointed by him six days before the sale as his attorney-in-fact to manage certain properties of his. It was proved that at the time of sale, he knew what he was doing, although three years later, he was declared an incompetent and placed under guardianship. *Issue:* Is the sale valid?

HELD: Under the premises, the sale is valid because the facts proved do not show undue influence or insidious machinations nor weakness of mind, despite the declaration later on of *subsequent* incompetence.

(3) Undue Influence Caused by Third Person

Undue influence exercised by a third party vitiates consent, just like in the case of violence and intimidation. (*See Memorandum to the Joint Congressional Committee on Codification, Mar. 8, 1951*).

(4) Contracts of Adhesion

Contracts where one party merely signs carefully prepared contracts by big companies (adhesion contracts or contracts of

adherence, like insurance or transportation contracts) should be strictly interpreted against the company, and liberally in favor of the individual, because the individual is “usually helpless to bargain for better terms.” (*See Observations on the New Civil Code by Justice J.B.L. Reyes, Lawyer’s Journal, Jan. 31, 1951, p. 49*).

Art. 1338. There is fraud when, through insidious words or machinations of one of the contracting parties, the other is induced to enter into a contract which, without them, he would not have agreed to.

COMMENT:

(1) Kinds of Fraud

(a) Fraud in the CELEBRATION of the contract (this is fraud proper):

1) *Dolo causante* (or causal fraud): Here, were it not for the fraud, the other party would not have consented. (This is the fraud referred to in *Art. 1338, Civil Code*.) *Effect* of this kind of fraud: The contract is VOIDABLE.

2) *Dolo incidente* (or incidental fraud): Here, even without the fraud the parties would have agreed just the same, hence the fraud was only incidental in causing consent. Very likely though, different terms would have been agreed upon. *Effect* of this kind of fraud: The contract is *valid*, but there can be an action for damages. (*See Woodhouse v. Halili, 93 Phil. 526*).

(b) Fraud in the PERFORMANCE of the obligations stipulated in the contract.

(NOTE: This kind of fraud presupposes the existence of an already perfected contract.)

(Example: Although real vinegar was sold, what was really delivered was diluted vinegar.)

(2) Dolo Causante

This is the use of insidious words and machinations by one of the contracting parties to induce the other party to enter into

a contract, which, without them, he would not have agreed to. (*Art. 1338, Civil Code*).

(3) Requisites of Dolo Causante

- (a) The fraud must be *material* and *serious*, that is, it really *induced* the consent. (*Art. 1344, Civil Code*).
- (b) The fraud must have been employed by only *one* of the contracting parties, because if both committed fraud, the contract would remain valid. (*See Art. 1344, Civil Code*).
- (c) There must be a *deliberate intent* to deceive or to induce; therefore, misrepresentation in GOOD FAITH is not fraud. (*See Art. 1343, Civil Code*).
- (d) The other party must have *relied* on the untrue statement, and must himself *not* be guilty of negligence in ascertaining the truth. (*See Songco v. Sellner, 37 Phil. 254*).

(NOTE: In marriage contracts, *dolo causante* is limited to the three cases specified in Art. 86.)

(4) Material and Serious Fraud

Examples:

- (a) A wanted to have himself insured, but because he was afraid he could *not pass* the medical examination, he had another person examined in his place. Here the contract of insurance is voidable. (*Eguaras v. Great Eastern Life Assurance Co., 33 Phil. 263*).
- (b) Concealment by the applicant for insurance that he had suffered from a number of ailment, including incipient pulmonary tuberculosis, and of the name of the hospital and of the physician who had treated him. (*Musngi v. West Coast Life Insurance Co., 61 Phil. 864*).
- (c) Misrepresentation by the vendor of the boundaries of his land by showing valuable properties *not really* included in his title. (*Gomez Marino v. Linton, 45 Phil. 652*).
- (d) Misrepresentation of law. (*Gonzales v. Gonzales, Lloret, Jan. 17, 1922 and R.G. 1652 L. J. May 31, 1938, pp. 466-467*).

Tuason v. Marquez
45 Phil. 381

FACTS: When an electric light plant was sold, the seller did *not* reveal that he had *given up* the franchise. The franchise, however, was NOT the determining cause of the purchase of the plant. **Issue:** May the sale be annulled?

HELD: No, for the absence of the franchise was *immaterial* in this particular purchase. Moreover, ascertainment of the status of the franchise could have been had by simply inquiring at the Office of the Public Service Commission.

- (e) The mere insertion in a deed of sale that the vendor is married when as a matter of fact he is not, is NOT sufficient evidence of fraud if this fact was not the inducing factor that led to the sale. (*Porciuncula, et al. v. Adamos, L-11519-20, Apr. 30, 1958*).
- (f) When a married man conceals deliberately his marriage so as to be able to carnally have another girl and the latter is forced to give up her employment because of such family trouble, he commits actual fraud upon her, and should therefore be liable for damages. (*Silva, et al. v. Peralta, L-13114, Nov. 25, 1960*).

(5) Fault of Party Injured

Azarraga v. Gay
52 Phil. 599

FACTS: A buyer of land before buying was allowed to investigate for himself the boundaries and the true nature of the land, even after the seller had told him about it. The seller did nothing to prevent the investigation from being completed. Later the buyer brought an action to annul the contract, alleging that false representations had been made to him. **Issue:** Will the action prosper?

HELD: No. The action will not prosper inasmuch as he (the buyer) had the opportunity to verify for himself the representations of the seller.

Gregorio Araneta, Inc. v. Tuason de Paterno
91 Phil. 686

FACTS: The vendor was intelligent and well-educated. She was accustomed to handling her own business affairs. She was ably assisted by legal counsel. Her son was a leading businessman. *Issue:* Under the circumstances, can she ordinarily say that she was deceived when she entered into a real estate deal?

HELD: No. In a case like this, the party who alleges the fraud must present full and convincing evidence thereof.

- (a) If one party is able to read and understand, and yet affixes his signature without reading, his negligence will prevent the annulment of the contract. (*See Ayola v. Valderrama Lumber Manufacturing Co., Inc., [C.A.] 49 O.G. 980*).
- (b) Supposing both parties had the opportunity to know the exact nature of the subject matter of the contract, will an action for annulment due to deceit prosper?

ANS.: No, the action for annulment will not lie. Where the means of knowledge are at hand and equally available to both parties, the buyer will not be heard to say he has been deceived. And if any act is done by the complaining party after discovering the alleged fraud or mutual mistake toward carrying out the contract, it shows an irrevocable election to abide by the contract.

(6) Entrance Into a Ridiculous Contract

Suppose a man enters into a ridiculous contract because of a wrong judgment although he is well in possession of his mental faculties, will the court grant a relief by annulling the contract?

ANS.: No, for in this case, it was the man's own fault. The Supreme Court said: "All men are presumed to be *sane* and *normal* and subject to be moved by substantially the same motives. When of age and sane, they must take care of themselves. In their relations with others in the business of life, wits, sense, intelligence, training, ability, and judgment meet and clash and contest, sometimes with gain and advantage to all, sometimes to a few only, with loss and injury to others.

“In these contests, men must depend upon themselves, upon their own abilities. The fact that one may be worsted by another, of itself, furnishes no cause of complaint. One man cannot complain because another is more able, or better trained, or has a better sense of judgment than he has; and when the two meet on fair field, the inferior cannot murmur if the battle goes against him. The law furnishes no protection to the inferior simply because he is inferior, anymore than it protects the strong, because he is strong. The law furnished protection to both alike, to one no more or less than the other. It makes no distinction between the wise and the foolish, the great and the small, the strong and the weak. The foolish may lose all they have to the wise; but that does not mean that the law will give it back to them again.”

“Courts cannot follow every step of one’s life and extricate him from bad bargains, protect him from unwise investments, relieve him from one-sided contracts, or annul the effects of foolish acts. Courts operate not because one person has been defeated or overcome illegally.”

“Men may do foolish things, make ridiculous contracts, use miserable judgment, and lose money on them — indeed, all they have in the world but *not* for that alone can the law intervene and restore. There must be, in addition, a violation of law, the commission of what the law knows as an *actionable* wrong, before the courts are authorized to lay hold of the situation and remedy it.” (*Vales v. Villa*, 35 Phil. 769).

Art. 1339. Failure to disclose facts, when there is a duty to reveal them, as when the parties are bound by confidential relations, constitutes fraud.

COMMENT:

(1) Failure to Disclose Facts

- (a) Failure to disclose facts (CONCEALMENT) constitutes FRAUD, when *there is a duty to reveal them*.
- (b) There is a duty to reveal in the following cases, for example: when the parties are bound by *confidential relations* (Art. 1339) as in the case of partners. (*Poss v. Gottlieb*, 118 Misc. 318).

Poss v. Gottlieb
118 Misc. 318

FACTS: A and B were real estate partners. A heard of a possible purchaser of a certain parcel of land owned by the firm. But A did not inform B. Instead, A persuaded B to sell to him (A) B's share at a nominal amount, after which A sold the whole parcel at a big profit. B sued A for damages for alleged deceit. A's defense was that he after all had *not* been asked by B about possible purchasers.

HELD: A is liable, for he should not have made any concealment. Good faith not only requires that a partner should not make any *false* concealment, but he also should abstain from *all concealment*.

Cadwallader and Co. v. Smith, Bell and Co.
7 Phil. 461

FACTS: An agent persuaded his principal to sell certain properties to himself at a low price. The agent did not reveal that the government was interested in acquiring said properties at much higher prices. *Issue:* Is the sale to the agent voidable?

HELD: Yes, because of his fraudulent concealment.

Strong v. Gutierrez Repide
41 Phil. 947

FACTS: A member of the board of directors of a corporation, thru an agent, purchased the stocks of a certain stockholder without revealing to the latter that negotiations were being made to *enhance* the value of the corporated stock. *Issue:* Is the purchase fraudulent?

HELD: Yes, in view of the fraudulent concealment.

(2) Opponents in a Litigation

There would seem to be no duty to disclose facts, as between opponents in a litigation for their relations, far from being friendly or confidential, are openly antagonistic. (*Escudero, et al. v. Flores, et al.*, 97 Phil. 240).

Art. 1340. The usual exaggerations in trade, when the other party had an opportunity to know the facts, are not in themselves fraudulent.

COMMENT:

Usual Exaggerations in Trade

- (a) This Article stresses the rule of “*caveat emptor*” (let the buyer beware).

**Dacusin v. Court of Appeals
80 SCRA 89**

The maxim “*caveat emptor*” simply means that a buyer must be on his guard. It is his duty to check the title of the seller, otherwise the buyer gets the object at his own risk.

- (b) The “usual exaggerations in trade” (dealer’s talk) constitute *tolerated fraud, when the other party had an opportunity to know the facts*.
- (c) The law, according to the Supreme Court in the case of *Songco v. Sellner*, 37 Phil. 254, allows considerable latitude to seller’s statement or dealer’s talk; “and experience teaches that it is exceedingly risky to accept it at its face value.” This is particularly so when a dealer *refuses to warrant his estimate*. A man who relies upon an affirmation made by a person whose interest might so readily prompt him to exaggerate the value of his property, does so at his own risk. He must therefore take the consequences of his own imprudence.
- (d) Ordinarily, what does not appear on the face of the written contract should be regarded as “trader’s talk” or “dealer’s talk.” (*Puyat v. Arco Amusements Co.*, 72 Phil. 402).

Art. 1341. A mere expression of an opinion does not signify fraud, unless made by an expert and the other party has relied on the former’s special knowledge.

COMMENT:**(1) Mere Expression of an Opinion**

- (a) *Example:* A, on buying a watch, was assured by the seller that it was a good watch, and could run without rewinding for one week, in the opinion of the seller. This is a mere expression of opinion that is not fraudulent. But if the seller was a watch expert, and the only reason why A bought the watch was this opinion of the seller, the contract is voidable on the ground of fraud.
- (b) If a seller says that in his opinion his land is first class, but it turns out to be second class, the sale is not fraudulent, particularly when the buyer had opportunity to examine the land for himself. (*Puato v. Mendoza*, 64 Phil. 457).
- (c) Reason for the rule on an *expert's opinion*:

The opinion of an expert is almost in the same category as a fact, particularly when this expert's knowledge is relied upon by the other party.

(2) Problem

X, desiring to buy certain property, hired an expert to ascertain its true value. But the expert's opinion turned out to be wrong and X was, therefore misled. May X ask for the annulment of the contract?

ANS.: No, because his own expert (and therefore his employee) committed the error. (*See Commission Memorandum to the Joint Committee on Codification, Mar. 8, 1951*).

Art. 1342. Misrepresentation by a third person does not vitiate consent, unless such misrepresentation has created substantial mistake and the same is mutual.

COMMENT:**(1) Misrepresentation by a Third Person**

How does the participation of a third person in *force* and in *fraud* or *misrepresentation* differ?

ANS.:

- (a) Force or intimidation by a third person makes the contract *voidable*.
- (b) Fraud by a third person does *not* make the contract voidable unless —
 - 1) the representation has created *substantial* mistake, and
 - 2) the mistake is mutual. (*Art. 1342*).

In this case, the contract may be annulled, not principally on the ground of fraud, but on the ground of error or mistake.

(2) Query

Is it not better to consider misrepresentation by a third person as a ground for annulment even if the same has not resulted in mutual mistake? After all, it cannot be denied that here, the consent is vitiated just the same.

(3) Case

Hill v. Veloso 31 Phil. 160

FACTS: A and B entered into a contract with X. A's consent was obtained only because B had deceived or defrauded him. May A ask for annulment of the contract with X?

HELD: No, because X was not a party to the fraud.

Art. 1343. Misrepresentation made in good faith is not fraudulent but may constitute error.

COMMENT:

Misrepresentation Made in Good Faith

Example: A bought a certain article from B. The article was needed for A's radio. B honestly but mistakenly assured A that the article was the proper object. May the contract be annulled?

ANS.: Yes, not on the ground of fraud, for the misrepresentation was honest, but on the ground of substantial error.

Art. 1344. In order that fraud may make a contract voidable, it should be serious and should not have been employed by both contracting parties.

Incidental fraud only obliges the person employing it to pay damages.

COMMENT:

(1) Requisites for Fraud to Vitiate Consent

Two requisites for fraud as a ground for annulment are given in this Article:

- (a) the fraud must be serious;
- (b) the parties must not be *in pari delicto* (mutual guilt), otherwise, neither party may ask for annulment. The contract would, therefore, be considered valid. (*See Valdez v. Sibal, 46 Phil. 930*).

(2) Incidental Fraud Does Not Vitiate Consent

Incidental fraud should *not* be confused with causal fraud. Incidental fraud is *not* a cause for annulment.

Art. 1345. Simulation of a contract may be absolute or relative. The former takes place when the parties do not intend to be bound at all; the latter, when the parties conceal their true agreement.

COMMENT:

(1) ‘Simulation of a Contract’ Defined

It is the process of intentionally deceiving others by producing the appearance of a contract that really *does not* exist (absolute simulation) or which is *different* from the true agreement (relative simulation). (*See TS, Dec. 19, 1951*).

(2) Requisites for Simulation

- (a) An outward declaration of will *different* from the will of the parties;
- (b) The false appearance must have been intended by *mutual agreement*;
- (c) The purpose is to *deceive third persons*.

Art. 1346. An absolutely simulated or fictitious contract is void. A relative simulation, when it does not prejudice a third person and is not intended for any purpose contrary to law, morals, good customs, public order, or public policy binds the parties to their real agreement.

COMMENT:**(1) Kinds of Simulated Contracts**

- (a) Absolutely *simulated (simulados) fictitious contracts*:
 - 1) Here, the parties do not intend to be bound.
 - 2) *Effect*: The contract is VOID.
- (b) Relatively *simulated (disimulados) disguised contracts*:
 - 1) Here, the parties conceal their true agreement.
 - 2) *Effect*: The parties are bound to the real or true agreement except —
 - a) if the contract should prejudice a third person;
 - b) or if the purpose is contrary to law, morals, good customs, public order, or public policy.

(2) Examples

- (a) *Absolutely Simulated*:

As a joke, A and B executed a deed of sale although they did not intend to be bound at all by the contract.

[NOTE: An absolutely simulated contract is inexistent and VOID. (*De Belen v. Collector of Customs*, 46 Phil. 241).]

(b) *Relatively Simulated:*

Although a deed of sale was made, the parties really intended a donation but they wanted to conceal the existence of the donation (simulation of the NATURE of the contract); or a true sale at a *different* price had really been agreed upon (simulation of the CONTENT or TERMS of the contract).

(NOTE: Third persons should not be prejudiced; therefore, as to them, the *apparent or ostensible* contract is the one valid. Reason: The contracting parties are in *estoppel*, and they should be penalized for their *deception*.)

(3) **‘Absolutely Simulated Contract’ Distinguished from an Illegal Contract**

In *Rodriguez v. Rodriguez*, GR L-23002, July 31, 1967, the Supreme Court held that in *simulation*, the contract is *not* really desired to produce an illegal effect or in any way alter the juridical situation of the parties; whereas an illegal contract is intended to be *real* and *effective*, and entered in such form as to circumvent a prohibited act.

(4) **Case**

**Edilberto Cruz and Simpliciano Cruz v. Bancom
Finance Corp. (Union Bank of the Phils.)
GR 147788, Mar. 19, 2002**

FACTS: Although the Deed of Sale between petitioners and Candelaria Sanchez stipulated a consideration of P150,000, there was actually no exchange of money between them. Respondent never offered any evidence to refute the foregoing. On the contrary, it even admitted that the stipulated consideration of P150,000 in the Deed of Sale had never been actually paid by Sanchez to petitioners.

HELD: The Deed of Sale were absolutely simulated, hence, null and void. (*Francisco v. Francisco-Alfonso*, GR 138774, March 8, 2001). Thus, it did not convey any rights that could ripen into a valid titles. (*Velasquez v. CA*, 345 SCRA 468 [2000]).

There being no valid real estate mortgage, there could also be no valid foreclosure or valid auction sale, either. At bottom, respondent cannot be considered either as a mortgagee or as a purchaser in good faith. This being so, petitioners would be in the same position as they were before they executed the simulated Deed of Sale in favor of Sanchez; they are still the owners of the property. (*GSIS v. CA*, 287 SCRA 204 [1998]).

[NOTE: A deed of sale, in which the stated consideration had not, in fact, been paid, was “a false contract, “i.e., *void ab initio*. (*Rongarilla v. CA*, 294 289 [1998]). “A contract of purchase and sale is null and void and produces no effect whatsoever where it appears that [the] same is without cause or consideration which should have been the motive thereof, or the purchase price which appears thereon as paid but which, in fact, has never been paid by the purchaser to the vendor. (*Ocejo v. Flores*, 80 Phil. 921 {1920}).]

Section 2

OBJECT OF CONTRACTS

Art. 1347. All things which are not outside the commerce of men, including future things, may be the object of a contract. All rights which are not intransmissible may also be the object of contracts.

No contract may be entered into upon future inheritance except in cases expressly authorized by law.

All services which are not contrary to law, morals, good customs, public order or public policy may likewise be the object of a contract.

COMMENT:

(1) Object (Subject Matter) of a Contract

The object of a contract is really to create or to end obligations which, in turn, may involve things or services. Hence, elliptically, it may be said that the object of a contract is a thing or a service.

(2) Requisites

- (a) the thing or service must be within the commerce of man;
- (b) must be transmissible;
- (c) must not be contrary to law, morals, good customs, public order, or public policy;
- (d) must not be impossible (*Art. 1348, Civil Code*);
- (e) must be determinate as to its kind or determinable without the need of a new contract or agreement. (*Art. 1349, Civil Code*).

(3) Within the Commerce of Man

If the object is outside the commerce of man, such as sidewalks (*Muyot v. De la Fuente*, [C.A.] 48 O.G. 4866) or public plazas (*Mun. of Cavite v. Rojas*, 30 Phil. 602), or public bridges, they cannot be the object of contracts of alienation (but may be the object, for example, of a contract for *repair*). Taxes are fixed by law, and are *not* subject to contract between the taxpayer and tax officer, except when there is an actual compromise. (*Coll. of Int. Rev. v. Ellen Wood McGrath*, L-12710, L-12721, Feb. 28, 1961). The right to present one's candidacy for a public office cannot be the object of a contract. Hence, a *defeated* candidate in a *party convention* who has previously agreed *not to run* for public office (if defeated in such convention) cannot be successfully sued for breach of the agreement. (*Saura v. Sindico*, L-13403, Mar. 23, 1960).

**Leonardo Navarro v. Luis L. Lardizabal, et al.
L-25361, Sept. 28, 1968**

FACTS: Juanita Cachero, lawful holder of a stall in the public market in Baguio City allowed Leonardo Navarro to occupy the same for more than 6 months. Navarro then formally applied for the award of the stall to him. The City Market Committee *postponed indefinitely* the awarding of the stall upon the protest of a certain D.B. Baton. Navarro sued for prohibition (to prohibit the Baguio City officials from delaying the award). **Issue:** Will the suit prosper?

HELD: The suit will *not* prosper, for Navarro has not shown that he already has a legal right to the stall, his application

being merely pending. The right to lease and occupy a stall in a public market is not a common right, but a purely statutory privilege, governed by laws and ordinances. (*Samson v. Fugoso*, 45 O.G. 300). The occupancy of the stall cannot be the subject of a valid contract as between the authorized stallholder and his transferee, unless the agreement is approved by the City authorities concerned.

Francisco Cuison, et al. v. Jose Ramolete
GR 51291, May 29, 1984

A probate court has NO jurisdiction to order the sale of properties belonging to registered owners (with Certificates of Title), if said owners are *not* parties to the proceedings, and this is so even if the properties had been included in the inventory submitted by the administrator of the estate.

(4) Transmissible

All rights which are not intransmissible may be the object of contracts. But strictly political rights (like the right to vote) or strictly personal rights (like parental authority) cannot be the subject of a contract.

(5) Not Contrary to Law, Morals, etc.

- (a) Future things may be the object of a contract; thus, the future harvest of sugarcane in a specific field may be *sold*; but by *express provision* of law, said future property may not be *donated*.
- (b) *Future inheritance* (one where the source of property is *still* alive) cannot be the subject of a contract except:
 - 1) in the case of marriage settlements. (*See Art. 130, Civil Code*);
 - 2) in the case of partitions of property *inter vivos* by the deceased. (*See Art. 1080, Civil Code*).

[NOTE: Future inheritance is any property or right not in *existence* or capable of determination, at the time of the contract, that a person may in the

future acquire by succession. (*Maria Gervacio Blas, et al. v. Rosalinda Santos, et al., L-14070, Mar. 29, 1961*).]

(c) *Illustrative Questions:*

- 1) When his father died, but before delivery of the property to him, a son sold his share of the property inherited. Is the sale valid?

ANS.: Yes, the sale is valid. The inheritance here is not future inheritance, but existing inheritance, although as yet undelivered. Ownership is transferred automatically to the heir upon the death of the decedent. *Said the Supreme Court:* "The properties of an existing inheritance cannot be considered as another's property with relation to the heirs who, through a fiction of law, *continue* the personality of the owner. Nor do they have the character of future property because the predecessor in interest having already died, his heirs acquired a right to succeed him from the moment of his death. An inheritance already existing, which is no longer future from the moment of death of the predecessor, may legally be the object of contract." (*Osorio v. Osorio and Inchausti Steamship Co., 41 Phil. 513*).

- 2) While his father was still alive, A sold to B the property he (A) expected to receive from his father. Is the contract valid?

ANS.: No, because the object of the contract here is really future inheritance, and the particular contract in this case is not one of those authorized by law regarding inheritance. (*Tordilla v. Tordilla, 60 Phil. 162*).

- 3) Some future heirs divided the property they expected to inherit from their mother, at a time when she was still alive. Is such partition of property valid?

ANS.: No. This is a contract relating to a future inheritance (for the mother is still alive) and does not come under the category of those contracts authorized by law concerning future inheritance. The owner (the

mother) could have made a partition among the heirs, but since the partition was made here not by her, but by the heirs, the same is void, under the second paragraph of Art. 1271 of the old Civil Code. (*Now the second paragraph of Art. 1347 of the New Civil Code*). (*Arroyo v. Gerona*, 58 Phil. 226).

(6) No Extension After Expiration

Gindoy v. Tapucar 76 SCRA 31

If a lease has expired, the trial court can no longer extend the same without the consent of both lessor and lessee.

(7) Human Blood is not an Object of Contract

The human blood, like other parts of the human body, cannot be considered object of contracts (*Art. 1347, Civil Code*) because they are outside the commerce of men. As such, the extraction, collecting, and selling of human blood by any individual or agency (*e.g.*, People's Blood Bank) is an aspect of the medical profession and should not be considered a taxable entity for business tax purposes.

The word "donation" instead of "selling" should be used as the euphemisms for the act of "giving away" or "transferring to another" "any part of the human body for scientific purposes, to save life or to advance the cause of medical science." "Sale" of human blood is not taxable activity for business tax purposes.

Art. 1348. Impossible things or services cannot be the object of contracts.

COMMENT:

(1) Impossible Things or Services

Impossibility may be:

- (a) because of the *nature* of the transaction or because of the *law*;
- (b) absolute (*objectively impossible*) (here, NO ONE can do it);

- (c) relative (*subjectively impossible*) (here, the particular debtor cannot comply).

(NOTE: Generally, the impossibility referred to by the law is absolute impossibility.)

[NOTE: If a *blind* man enters into a contract which requires the use of his eyesight, the contract is void although in this particular case, we have only a relative impossibility. (8 *Manresa* 685). This is because here, the relative impossibility is *not merely temporary*.]

(2) Impossibility Not to Be Confused from Mere Difficulty

Impossibility must not be confused with difficulty. Hence, a showing of mere inconvenience, unexpected impediments, or increased expenses is *not enough*. (*Castro, et al. v. Longa*, 89 *Phil.* 581).

Art. 1349. The object of every contract must be determinate as to its kind. The fact that the quantity is not determinate shall not be obstacle to the existence of the contract, provided it is possible to determine the same, without the need of a new contract between the parties.

COMMENT:

Object of the Contract

- (a) The object must be determinate or determinable (without need of a new agreement).
- (b) If the object is not determinate or determinable, the contract is void for want of an essential requisite — the object of the contract.
- (c) If A promised to give B this (*blank*), it is clear that there can be no obligation here.
- (d) But if A sold to B the future (2006) harvest in A's field for a definite price, the contract is valid for there is *no need* of a new agreement.

Section 3

CAUSE OF CONTRACTS

Art. 1350. In onerous contracts the cause is understood to be, for each contracting party, the prestation or promise of a thing or service by the other; in remuneratory ones, the service or benefit which is remunerated; and in contracts of pure beneficence, the mere liberality of the benefactor.

COMMENT:

(1) 'Cause' Defined

It is the essential and impelling reason why a party assumes an obligation. (*8 Manresa 677*). Strictly speaking, there is no cause of a contract, but there is a cause for an *obligation*.

**Private Development Corp. of the
Phils. v. IAC & Ernesto C. del Rosario
GR 73198, Sept. 2, 1992**

Inasmuch as the loan agreement herein was entered into on May 21, 1974, the prevailing law applicable is Act 2655, otherwise known as the Usury Law, as amended by PD 116, which took effect on Jan. 29, 1974.

Sec. 2 of Act 2655 provides that “[n]o person or corporation shall directly or indirectly take or receive money or other property, real or personal, or chases in action, a higher rate of interest or greater sum or value including commissions, premiums, fines and penalties, for the loan or renewal thereof or forbearance of money, goods or credit, where such loan or renewal or forbearance is secured in whole or in part by a mortgage upon real estate, the title to which is duly registered or by a document conveying such real estate at an interest, higher than twelve percent per annum.”

The Usury Law, therefore, as amended by PD 116, fixed all interest rates for all loans with maturity of more than 360 days at 12% per annum including premiums, fines and penalties. It is to be noted that PDCP was charging penalties at the rate of 2% per month or an effective rate of 24% per annum on the peso loan and 1/2% per month or an effective 6% per annum on the

foreign currency loan. It is, therefore, very clear that PDCP has been charging and imposing interests in violation of the prevailing usury laws. Be it noted further that in the beginning, PDCP was charging a total of 19% interest per annum on the peso loan and 18 3/4% on the foreign currency loan. Since the penalty charge was increased to 2% per month with regard to the peso loan, PDCP began charging a total of 42% per annum on the peso loan, clearly in violation of the Usury Law. For instance, Davao Timber Corporation obtained a loan of P4.4 million and has paid a total of about P3 million, the remaining balance on the principal debt left unpaid is about P1.4 million, to which respondents must still pay the petitioner. The law should not be interpreted to mean forfeiture of the principal loan as that would be unjustly enriching the borrower. The unpaid principal debt still stands and remains valid but the stipulation as to the usurious interest is void; consequently, the debt is to be considered without stipulation as to the interest.

In a simple loan with stipulation of usurious interest, the prestation of the debtor to pay the principal debt, which is the cause of the contract (*Art. 1350, Civil Code*), is not illegal. The illegality lies only as to the prestation to pay the stipulated interest; hence, being separable, the latter only should be deemed void, since it is the only one that is illegal. The foregoing interpretation is reached with the philosophy of usury legislation in mind; to discourage stipulations on usurious interest, said stipulations are treated as wholly void, so that the loan becomes one without stipulation as to the payment of interest. It should not, however, be interpreted to mean forfeiture even of the principal, for this would unjustly enrich the borrower at the expense of the lender. Furthermore, penal sanctions are available against a usurious lender, as a further deterrence to usury. The principal debt remaining without stipulation for payment of interest can thus be recovered by judicial action.

(2) ‘Cause’ and ‘Subject Matter’ Distinguished

The difference is only a matter of viewpoint in some way, because what may be the subject matter for one party will be the cause or consideration for the other party.

Example: A is obliged to sing at a concert, in return for which she will receive a car from B.

Regarding A, the subject matter is the singing; the cause is the car.

Regarding B, the subject matter is the car; the cause is the singing.

Hence, we can form this general conclusion: In reciprocal contracts, the subject matter for one is the cause for the other, and *vice versa*.

(3) Bar Question

If a particular piano is sold for P500,000 what is the *object* and what is the *cause*?

ANS.: There are two schools of thought here.

- (a) According to *Manresa*, for the *seller* the object is the piano and the cause is the price; for the *buyer* the object is the price and the cause is the piano.
- (b) According to *others*, for both the seller and the buyer, there is just one object, namely, the piano. The cause for the seller is the *price*; the cause for the buyer is the delivery of the *piano*.

(4) Classification of Contracts as to Cause

- (a) *Onerous* — here the cause is, for each contracting party, the prestation or promise of a thing or service by the other.

Example: contract of sale

- (b) *Remuneratory* — the past service or benefit which by itself is a *recoverable debt*.

[NOTE: In a remuneratory *donation*, the past service or debt is *not* by itself a recoverable debt. (See Art. 726, Civil Code).]

- (c) *Gratuitous* (or contracts of pure beneficence) — here, the cause is the mere liability of the benefactor.

Example: pure donation

(5) Cause in Accessory Contracts Like Mortgage and Pledge

Here generally, the cause is the same as the cause for the principal contract of loan. (*China Banking Corporation v. Lichauco*, 46 Phil. 460).

**Phil. Guaranty, Inc. v. Dino, et al.
L-10547, Jan. 31, 1958**

FACTS: The Phil. Guaranty Co. put up a bond for Dino in a court action. In turn, Manalastas executed a mortgage in favor of the Phil. Guaranty Co. as counter-guaranty for Dino's bond. **Issue:** Does the mortgage executed by Manalastas have any cause or consideration?

HELD: Yes. The cause was the execution of the bond by the corporation in favor of Dino. It is not necessary that such consideration should redound directly to the benefit of Manalastas; it is enough that it be favorable to Dino.

**Garrido v. Perez Cardenas
60 Phil. 964**

Where one of the signers of a promissory note was indebted to the payee in the amount of P2,000 and to secure its payment the defendant signed the note together with said debtor *in solidum*, the said debt is sufficient consideration for the execution of the note as to the defendant.

(6) Cause in Accessory Contracts of Personal Guaranty (Guaranty and Suretyship)

Here the cause is, generally, *pure liberality*. (*Standard Oil Co. v. Arenas*, 19 Phil. 363). As a matter of fact, the contract of guaranty is gratuitous, unless there is stipulation to the contrary. (*Art. 2048, Civil Code*). Sometimes, however, some material consideration may be given. (*Standard Oil Co. v. Arenas, op. cit.*).

(7) Moral Obligation as a Valid Cause of a Civil Obligation

A moral obligation may be the cause of a civil obligation. (*Villaroel v. Estrada*, 71 Phil. 140). Of course, if the moral obli-

gation really does not exist, there is no valid cause, as when the promise was made on the erroneous belief that one was morally responsible for the failure of a certain particular enterprise. (*Fisher v. Robb*, 69 *Phil.* 101).

Mactal v. Melegrito
L-16114, Mar. 24, 1961

FACTS: Mactal gave Melegrito P1,770 for the purchase of *palay* in behalf of the former, with the obligation of returning the amount within 10 days, if not spent for said purpose. The agent neither bought the *palay* nor returned the money. Mactal thus accused him of *estafa*. Melegrito persuaded Mactal to drop the case, and in turn he (Melegrito) executed a promissory note in favor of the other for the amount involved. *Issue:* Is the promissory note valid?

HELD: Yes, for its cause or consideration was not the dismissal of the *estafa* case, but the pre-existing debt of Melegrito — the amount that had been given to him.

(8) Shocking Cause or Consideration

Javier v. Vda. de Cruz
80 SCRA 343

A supposed sale by a dying man of a parcel of land consisting of more than 18 hectares to his houseboy for only P700.00 is shocking to the conscience and void. Besides, the thumbmark of the seller on the deed cannot have been affixed voluntarily by said seller.

Ong v. Ong
GR 67888, Oct. 8, 1985

In deeds of conveyance that adhere to the Anglo-Saxon practice, it is not unusual to state that the consideration given is P1, although the actual consideration may be more. A one-peso consideration may be suspicious; this alone does not justify one to infer that the buyers are not buyers in good faith and for value. Neither does such inference warrant one to conclude that the sale is void *ab initio*. Bad faith and inadequacy of

monetary consideration do not render a conveyance inexistent. The assignor's liberality could be a sufficient cause for a valid contract.

Art. 1351. The particular motives of the parties in entering into a contract are different from the cause thereof.

COMMENT:

(1) Motives of the Parties for Entering Into a Contract

Example: I buy a gun from a store for P50,000 because I want to kill myself. The cause of the contract is the gun (for me); the money (for the seller). My motive, however, is the killing of myself. Motives do not enter at all in the validity or invalidity of cause or consideration.

(2) Motive Distinguished from Cause

- (a) The *motive* of a person may vary although he enters into the same kind of contract; the *cause* is always the same.
- (b) The motive may be *unknown* to the other; the cause is always *known*.
- (c) The presence of *motive* cannot cure the absence of *cause*.

(3) Statement of Distinction by the Supreme Court

"The motives which impel one to a sale or purchase are not always the consideration (cause) of the contract as that term is understood in law. One may purchase an article not because it is cheap, for in fact, it may be dear, but because he may have some particular use to which it may be put because of a particular quality which that article has or the relation to which it will be associated. These circumstances may constitute the motive which induces the purchase, but the real consideration of the purchase is the money which passed. With one's motives the law cannot deal in civil actions of this character, while with the consideration the law is always concerned." (*De Jesus v. G. Urrutia & Co.*, 33 Phil. 717).

(4) Illegal Cause Distinguished from Illegal Motive

An illegal cause makes a contract void; an illegal motive does not necessarily render the transaction void. *Example:* If I buy a knife to kill X, the purchase is still valid. (*See Gonzales, et al. v. Trinidad, et al.*, 67 Phil. 682). But if the purpose is to stifle a criminal prosecution, the contract is void. (*Reyes v. Gonzales, [C.A.] 45 O.G. 831 and 8 Manresa 627.*)

Art. 1352. Contracts without cause, or with unlawful cause, produce no effect whatsoever. The cause is unlawful if it is contrary to law, morals, good customs, public order or public policy.

COMMENT:**(1) Requisites for Cause**

- (a) It must be *present* (at the time the contract was entered into);
- (b) It must be *true* (not false);
- (c) It must be *lawful* (not contrary to law, morals, good customs, public order, or public policy).

(2) Existing Cause

- (a) If there is no cause whatsoever, the contract is VOID. Thus, a fictitious sale is VOID. (*Navarro v. Diego, [C.A.] 40 O.G. 2106.*)
- (b) Just because the seller was not the owner of the thing sold, it does *not* mean that there was lack of cause, for after all, there is a warranty (*See Levy v. Johnson, 44 Phil. 463*); nor does failure to pay the price result in a lack of cause. (*De la Cruz v. Legaspi, 51 O.G. 6212.*)

[NOTE that the cause must exist at the time of the perfection of the contract; *it need not exist later.* (*See Juan Serrano v. Federico Miave, et al., L-14678, Mar. 31, 1965.*)]

Carantes v. Court of Appeals
L-33360, Apr. 25, 1977

FACTS: The heirs of a deceased person assigned in 1939 their “Right to Inheritance” in favor of a co-heir in consideration of the sum of P1.00 and in further consideration of the fact that while the deceased was still alive, he had orally expressed that the *assignee co-heir* was actually the rightful owner of the property being assigned to him. It was alleged later, in an action to nullify the assignment, that the deed of assignment was void, there being no consideration therefor, and that the action to have the deed declared void does not prescribe because the deed itself was void. **Issues:** Was the contract of assignment valid? Does this kind of action prescribe?

HELD:

- (a) The contract of assignment is **VALID**, there being sufficient consideration therefor — the P1.00 consideration and the fact that the deceased had previously recognized the assignee to be the rightful owner of the property.
- (b) Since the contract is not void, an action to declare its nullity may prescribe.

(3) Bar Problem

On Jan. 5, A sold and delivered his truck together with the corresponding certificate of public convenience to B for the sum of P1.6 million, payable within 60 days. Two weeks after the sale, and while the certificate of public convenience was still in the name of A, the certificate was revoked by the Land Transportation Commission thru no fault of A. Upon the expiration of the 60-day period, A demanded payment of the price from B. B refused to pay, alleging that the certificate of public convenience which was the main consideration of the sale no longer existed. Is the contention of B tenable?

ANS.: No, for the certificate was in existence at the time of the perfection of the contract. Its subsequent revocation is of no consequence insofar as the validity of the contract is concerned. Besides, B was negligent in not having caused the immediate transfer of the certificate to his name. After all, it had already

been delivered to him. (*See Juan Serrano v. Federico Miave, et al.*, L-14678, Mar. 31, 1965).

(4) True Cause

If the cause is false, the contract is not valid unless some other cause which is lawful really exists. (*See Art. 1353, Civil Code*).

(5) Lawful Cause

- (a) If the cause is unlawful, the transaction is null and void.
- (b) Thus, a contract to stifle criminal prosecution for theft is void because this is manifestly contrary to public policy and the due administration of justice. (*Arroyo v. Berwin*, 36 Phil. 386).
- (c) A promissory note to cover a gambling debt (*Palma v. Canizares*, 1 Phil. 602), or to cover accumulated usurious debts, is VOID. (*Mulet v. People*, 73 Phil. 63).
- (d) A promise of marriage based on sexual intercourse is based on an illegal cause. (*Batarra v. Marcos*, 7 Phil. 156).
- (e) If a person claims that some parts of a contract are illegal but the rest are valid, he has the burden of showing which parts are supported by a lawful cause; otherwise, the whole contract shall be considered VOID. (*Lichauco v. Martinez*, 6 Phil. 694).
- (f) While an absolutely simulated contract can have *no* effect, a contract with an illegal cause may produce effects under certain circumstances where the parties are not of equal guilt. (*Liguez v. Court of Appeals, et al.*, L-11240, Dec. 18, 1957).

Liguez v. Court of Appeals, et al. L-11240, Dec. 18, 1957

FACTS: Salvador P. Lopez, a married man, gave Conchita Liguez, a 15-year-old girl, a donation of land so that she would have sexual relations with him and so that her parents would

allow them to live together. After Lopez's death, Conchita sought to get the land from his heirs, but said heirs refused on the ground that the cause or consideration of the donation was illegal, and that therefore the donation should be considered null and void. Conchita contended that while the *motive* might have been immoral, still the *cause* — “liberality” — was proper, and that therefore the donation should be considered valid.

HELD: The donation was null and void. While it is true that motive differs from *cause*, still a contract that is *conditioned* upon the attainment of an *immoral motive* should be considered void, for here motive may be regarded as cause when it *predetermines* the purposes of the contract. Here, Lopez would not have conveyed the property in question had he known that Liguez would *not* cohabit with him; it follows that the cohabitation was an implied condition to the donation, and being unlawful, the donation itself must be considered unlawful. Moreover, it *cannot* be said here that the donation was a “contract of pure beneficence” or a contract designed solely and exclusively for the welfare of the beneficiary. Indeed, the donation was made both to benefit Conchita and to gratify his own sexual desires. We have thus seen that the donation was immoral. Nevertheless, had Lopez been alive, he could not have invoked the immorality of the donation because it was he who was at fault; *thus Conchita is entitled to the land.*

[*NOTE:* The losers, the heirs of Lopez, filed a motion for reconsideration on the following grounds:

- (a) The donation being null and void, it should have no effect; therefore, Conchita cannot get the land;
- (b) Just because Lopez is estopped from questioning the legality of the donation, it does *not* mean that his heirs *cannot* question its validity;
- (c) Since both parties are *equally guilty*, they are *in pari delicto* (equal guilt), therefore the law should leave them as they are; therefore, Conchita, who has not been given actual possession of the property, *cannot* claim the same;
- (d) Finally, since Conchita has long delayed her recovery of the property, she is now guilty of estoppel by *laches* (un-

reasonable delay in bringing a court action); and therefore she should not recover the property.

In a decision promulgated Feb. 12, 1958 (*Liguez v. Court of Appeals, et al.*, L-11240), the court answered one by one the above-mentioned contentions:

- (a) There are two kinds of void donations: those made without the proper formalities (*inexistent* contract), and those which are illegal. The *first kind* is *inexistent* in law, and is open to attack even by the parties thereto; but the *second kind* is *not inexistent*, it is illegal, and under the Civil Code, *neither party* may invoke its unlawful character as a ground for relief.
- (b) If Lopez cannot question, his heirs cannot also question for they can have no better right than the predecessor whom they replaced. If at all the heirs can question, it should be on some other ground, like its being *inofficious*, for instance (one that would prejudice their legitime).
- (c) The *pari delicto* rule cannot apply because the guilt of a *minor* (Conchita was only 15) cannot be judged with equal severity as the guilt of an adult. Minors occupy a privileged position under the law.
- (d) The rule of estoppel by *laches* cannot apply in this case against Conchita; otherwise, we would be prevented from enforcing the principle that a party to an illegal contract cannot recover what he has given pursuant thereto. The latter rule is of superior public policy.]

(6) Effect if the Cause Is Illegal

- (a) If one party is innocent he cannot be compelled to perform his obligation, and he may recover what he has already given. (*See Art. 1411, Civil Code*).
- (b) If *both parties are guilty, in general*, neither can sue the other, the law leaving them as they are. But certain exceptions exist. (*See Arts. 1414, 1416, etc., Civil Code*).

Velez v. Ramas
40 Phil. 787

FACTS: An employee in a pawnshop named Restituta Quirante embezzled a sum of money from said pawnshop, and in order that she would *not* be prosecuted, her father and her husband signed a promissory note to pay the amount embezzled, with interest to the victim. When they did not pay, the victim instituted this action to recover the said amount. *Issue:* Can recovery be made?

HELD: No recovery can be made because the cause of consideration is illicit, namely, to prevent a prosecution for a crime. This was clearly the purpose of the father, and also the purpose of the husband. And even if the victim were to claim that even without that purpose the husband's intention was merely to pay that which he owes, as a member of the *conjugal partnership*, for his wife's act, still since the wife was not made a defendant in the instant case, the husband's liability *cannot* be enforced in the present proceeding.

Art. 1353. The statement of a false cause in contracts shall render them void, if it should not be proved that they were founded upon another cause which is true and lawful.

COMMENT:

Statement of a False Cause

- (a) Just because the cause stated is false does not necessarily mean that the contract is void. *Reason:* The parties are given a chance to show that a cause really exists, and that said cause is *true* and *lawful*.
- (b) Thus under this Article, it would seem that the contract with a statement of a false cause is not void, but merely revocable or voidable. (*Concepcion v. Sta. Ana*, 87 Phil. 787).

Art. 1354. Although the cause is not stated in the contract, it is presumed that it exists and is lawful, unless the debtor proves the contrary.

COMMENT:**Presumption That Cause Exists**

- (a) It is necessary that the cause must exist, BUT it is not necessary to STATE the cause in the contract. *Reason:* It is presumed that the cause EXISTS and is LAWFUL, unless the debtor proves the contrary. (*See Radio Corp. v. Roa, 62 Phil. 211*).
- (b) Under the Statute of Frauds, certain agreements have to be in writing. Now then, in these agreements, is it essential to put down the consideration in writing?

ANS.: No, because of the presumption under this Article that the cause exists. (*Behn, Meyer, & Co. v. Davis, 37 Phil. 431*).

- (c) A made a promissory note in B's favor. A, however, alleged that the cause was his gambling losses in a prohibited game. Who has the burden of proving that the game was indeed a prohibited one?

ANS.: A because under the law, the presumption is that the cause is lawful. (*See Rodriguez v. Martinez, 6 Phil. 594*).

Art. 1355. Except in cases specified by law, lesion or inadequacy of cause shall not invalidate a contract, unless there has been fraud, mistake or undue influence.

COMMENT:**(1) 'Lesion' Defined**

It is inadequacy of cause, like an insufficient price for a thing sold.

(2) Rules on Lesion

General Rule — *Lesion* or inadequacy of price does not invalidate a contract.

Exceptions:

- (a) When, together with *lesion*, there has been:

- 1) fraud
 - 2) mistake
 - 3) or undue influence
- (b) In cases expressly provided by law (in the following, the contracts may be *rescinded*):
- 1) “Those which are entered into by guardians whenever the wards they represent suffer *lesion* by *more than one-fourth* of the value of the things which are the objects thereof.” (*Art. 1381, par. 1, Civil Code*).
 - 2) “Those agreed upon in representation of absentees, if the latter suffer the *lesion* stated in the preceding number.” (*Art. 1381, par. 2, Civil Code*).
 - 3) Partition among co-heirs, when anyone of them received things with a value less by at least one-fourth than the share to which he is entitled. (*Art. 1098, Civil Code*).

(3) Problem

- (a) A guardian of A sold A’s mansion worth P120 million for P60 million. May the contract be rescinded on the ground of *lesion*?

ANS.: Yes, such a case is expressly provided for by the law as one of the contracts that may be rescinded on the ground of *lesion*.

- (b) A sold his mansion worth P120 million to B for only P60 million because A did not know the true value of the house. May the contract of sale be rescinded?

ANS.: No. As a rule *lesion* or inadequacy of price, by itself, does not invalidate a contract. But if A had sold it only for this amount because of fraud or mistake or undue influence, the contract may be annulled. *Said the Court:*

“Whether or not the price paid for the house was adequate need not be discussed for even granting that it was inadequate, that would not invalidate the sale. The fact that the bargain was a hard one coupled with mere inadequacy of a price when both parties are in a position to

form an independent judgment concerning the transaction, is not sufficient ground for the cancellation of a contract.” (*Garcia v. Manas*, [C.A.] 45 O.G. No. 4, p. 1815, citing *Askay v. Cosalan*, 46 Phil. 179).

(4) Lesion as Evidence of Vitiating Consent

Lesion may be EVIDENCE of the presence of fraud, mistake, or undue influence. (*Rosales de Echaz v. Gan*, 55 Phil. 527).

Chapter 3

FORM OF CONTRACTS

Art. 1356. Contracts shall be obligatory, in whatever form they may have been entered into, provided all the essential requisites for their validity are present. However, when the law requires that a contract be in some form in order that it may be valid or enforceable, or that a contract be proved in a certain way, that requirement is absolute and indispensable. In such cases, the rights of the parties stated in the following article cannot be exercised.

COMMENT:

(1) Generally, Form Is Not Required

In general, form does not matter for the validity of a contract. It is enough that there be *consent*, *subject matter*, and *cause*. This rule applies, however, to **CONSENSUAL CONTRACTS**.

[NOTE:

- (a) **FORMAL CONTRACTS (SOLEMN CONTRACTS)** require a certain specified form, in addition to *consent*, *subject matter*, and *cause*. (*Example: A donation of real property must be in a public instrument in order to be valid, even as between the parties.*)
- (b) **REAL CONTRACTS** require **DELIVERY** to be valid as a *real* contract even as between the parties, in addition to consent, subject matter, and cause.]

**Marlene Dauden-Hernaez v.
Hon. Walfrido de los Angeles, et al.
L-27010, Apr. 30, 1969**

FACTS: Marlene Dauden-Hernaez, a movie actress, sued a movie company (the Hollywood Far East Productions, Inc.) and its President and General Manager (Ramon Valenzuela), to recover P14,700 representing a balance allegedly due her for her services as a star in two movies, and to recover damages. The contract was an ORAL one. The lower court dismissed the case on the ground that under Art. 1358 of the Civil Code, since the contract price exceeded P500, the same should have been evidenced by a written instrument: *Issue:* Was the dismissal proper?

HELD: No, the dismissal was *not proper*. Generally, under Art. 1356 all contracts are valid, *regardless of form*. There are only two exceptions — first, when the contractual form is needed for VALIDITY as in the case of a donation of real property which needs a *public* instrument; secondly, when form is needed for ENFORCEABILITY under the Statute of Frauds. The contract for her services falls under *neither exception*. The contracts covered by Art. 1358 (such as her contract) are binding and enforceable by action or suit *despite the absence of any writing* because said article *nowhere provides that the absence of written form will make the agreement invalid or unenforceable*. In the matter of form, the contractual system of our Civil Code still follows that of the Spanish Civil Code of 1889 and of the “*Ordenamiento de Alcala*” of upholding the spirit and intent of the parties over formalities; hence, *generally*, oral contracts are valid and enforceable.

**Duque v. Domingo
80 SCRA 654**

It is difficult to believe that registered land has been partitioned orally, for to affect third parties any transaction affecting registered land should be evidenced by a public instrument (so that the document will be a registrable deed).

(NOTE: As between the parties, however, the oral partition may be regarded as valid.)

Heirs of del Rosario v. Santos
L-46892, Sept. 30, 1981

When a party admits the genuineness of a document, he also admits that the words and figures of the document are set out correctly, and that he waives all formal requisites required by law, such as the oath, acknowledgment, or revenue stamps.

(2) When Form Is Important

Form may be important:

- (a) For *VALIDITY* (This is true in formal or solemn contracts.)
- (b) For *ENFORCEABILITY* [This is true for the agreements enumerated under the Statute of Frauds, but of course this requirement may be waived by *acceptance of benefits* (partial) or by *failure to object* to the presentation of oral (parol) evidence. (See Art. 1403, Civil Code).]
- (c) For *CONVENIENCE* (This is true for the contracts enumerated for example under Art. 1385, Civil Code).

(3) Examples of Formal Contracts

(NOTE: If the form is not complied with, Art. 1457 of the Civil Code cannot be availed of.)

- (a) Donations of *real property* (these require a public instrument). (Art. 749, Civil Code).
- (b) Donations of *personal property* (these require a *written* contract or document if the donation exceeds P500). (Art. 748, Civil Code).
- (c) Stipulation to pay interest on loans, interest for the *USE* of the money (said stipulation must be in writing).
- (d) Transfer of large cattle (this requires the *transfer* of the certificate of registration). (Sec. 523, Rev. Adm. Code).

- (e) Sale of land thru an agent (here, the authority of the agent must be in writing; otherwise, the sale is null and void). (*Art. 1874, Civil Code*).
- (f) Contracts of *antichresis* (here the principal loan, and the interest if any, must be specified in *writing*; otherwise, the contract of antichresis is *void*). (*Art. 1773, Civil Code*).

(4) Some Problems

- (a) A donated real property to B in a private instrument. B accepted the donation. Is the donation valid?

ANS.: No, because the donation was *not* made in a public instrument. (*Camagay v. Lagera, 7 Phil. 397*).

- (b) Real property was donated in a *public instrument* but acceptance was made in a *private* instrument. Is the donation valid?

ANS.: No, because both the giving and the accepting must be in a public instrument. (*See Abellara v. Balanag, 37 Phil. 865*).

(NOTE: Registration in the Registry of Property of donations of real property is important only for effectivity as against *third persons*; as between the parties, a public instrument is sufficient.)

- (c) Is an oral sale of land valid as between the parties?

ANS.:

- 1) If the land had been delivered or the money has been paid, the sale is completely valid.

(NOTE: Although the Statute of Frauds requires this contract to be in writing, still said statute does *not* apply to executed or partially executed contracts.)

- 2) If the land has not yet been delivered and the price has not yet been paid, the sale is *unenforceable*, that is, neither party may be compelled by court action to perform *unless* the defense of the Statute of Frauds is waived.

(5) Case**Gallardo v. IAC
GR 67742, Oct. 29, 1987**

FACTS: Meliton claims that on Aug. 10, 1937, Pedro sold to him (Meliton) in a private document, an unnotarized deed of sale, allegedly signed by Pedro, now deceased, the property in question. Based on the private document of sale, the Original Certificate of Title was cancelled and a New Certificate of Title issued in the name of Meliton. The office of the Register of Deeds where the records were kept were destroyed. So, by an affidavit of reconstitution, dated Dec. 2, 1958, and upon presentation of the Owner's Duplicate Certificate of Title, the title was administratively reconstituted and the Register of Deeds issued the corresponding transfer certificate of title in the name of Meliton. On Nov. 17, 1976, Marta, the daughter of Pedro, executed and filed an affidavit of adverse claim with the Office of the Register of Deeds. On December 9, 1976, a deed of conveyance and release of claim was prepared which provided that Marta is withdrawing the adverse claim. But Marta refused to sign the affidavit of quitclaim.

Meliton sued Marta by filing a complaint for quieting of title. Marta countered that the deed of sale be declared null and void *ab initio*. The trial court declared the deed of sale of August 10, 1937 as well as the reconstituted certificate of title of Meliton void *ab initio*. The Intermediate Appellate Court affirmed the trial court. The Supreme Court sustained both the trial and appellate court.

HELD: The deed of sale is not registerable under the Land Registration Act. True, a private conveyance of registered property is valid between the parties. But the only right the buyer of registered property in a private document is to compel through court processes the seller to execute a deed of conveyance sufficient in law for registration purposes.

Meliton's reliance on Art. 1356 of the Civil Code is unfortunate. The general rule enunciated in Art. 1356 is that contracts are obligatory, in whatever form they may have been entered, provided all the essential requisites for their validity are present. The next sentence provides the exception, which requires a con-

tract to be in some form when the law so requires for validity or enforceability. Said law in Sec. 127 of Act 496 requires that the conveyance be executed “before the judge of a court of record or clerk of a court of record or a notary public or a justice of the peace, who shall certify such acknowledgment substantially in form next hereinafter stated.” Such law was involved here. The Register of Deed’s act in allowing the registration of the private deed of sale was authorized and did not validate the defective private document of sale.

Art. 1357. If the law requires a document or other special form, as in the acts and contracts enumerated in the following article, the contracting parties may compel each other to observe that form, once the contract has been perfected. This right may be exercised simultaneously with the action upon the contract.

COMMENT:

(1) Right of One Party to Compel the Other to Execute the Necessary Form

The Article applies only when *form* is needed only for *convenience*, *not* for validity or enforceability.

In other words, before the contracting parties may be compelled to execute the needed form, it is essential that the contract be:

- (a) perfected (valid) (*Art. 1357*);
- (b) enforceable under the Statute of Frauds. (*Art. 1356*).

[*NOTE:* Art. 1356 says that when the law requires that a contract be in some form in order that it may be *valid* or *enforceable*, that requirement is *absolute* and indispensable. In such cases, the right of the parties stated in the following article (Art. 1357 — the right to compel) cannot be exercised.]

[*NOTE:* A contract partly written and partly oral is, in legal effect, an ORAL contract. (*Manuel v. Rodriguez, Sr., L-13435, Jul. 27, 1960*).]

(2) Examples

- (a) *A* donated land to *B* in a private instrument. *B* accepted in the same private instrument. *B* then wanted to have the donation registered but registration requires a public instrument. So *B* requested *A* to put down the donation in a public instrument. But *A* refused. *B* then sued to compel *A* to observe the necessary form. Decide.

ANS.: *A* cannot be compelled under Art. 1357 because the donation is *not* valid.

- (b) Same as problem (a) except that the land has already been actually delivered to *B*. May *A* be compelled to execute the needed public instrument?

ANS.: Again the answer is NO, for the simple reason that the donation is null and void.

- (c) *A* sold to *B* in a private instrument his land. Later *B* wanted to have the sale registered, but registration requires a public instrument. May *B* compel *A* to execute the needed public instrument?

ANS.: Yes, because the contract is both *valid* and *enforceable* under the Statute of Frauds.

- (d) Same as (c) except that the sale was made orally. May *B* compel *A* to execute the needed public instrument?

ANS.: It depends:

- 1) If the contract is still executory — NO because the contract is not enforceable under the Statute of Frauds, which requires sales of real property to be in writing to be enforceable by court action.
- 2) If the price has been paid, or the land has been delivered — YES, because here the contract is both *valid* and *enforceable*.

(3) Cases

Jomoc v. CA
GR 92871, Aug. 2, 1991

FACTS: The subject lot forms part of the estate of the late Pantaleon Jomoc. Because it was fictitiously sold and trans-

ferred to third persons, Maria Vda. Jomoc, as administratrix of the estate and in behalf of all the heirs, filed suit to recover the property before the trial court (Civil Case 4750). Mariano So, the last of the transferees and the husband of Maura So, intervened. The case was decided in favor of Jomoc and was accordingly appealed by Mariano So and one Gaw Sur Cheng to the Court of Appeals. In Feb. 1979, pending the appeal, Jomoc executed a Deed of Extrajudicial Settlement and Sale of Land with Maura So for P300,000. The document was not yet signed by all the parties nor notarized but, in the meantime, Maura So had made partial payments amounting to P49,000. In 1983, Mariano So, the appellant in the recovery proceeding, agreed to settle the case by executing a deed of reconveyance of the land in favor of the heirs of Pantaleon Jomoc. The reconveyance was in compliance with the decision in the recovery case and resulted in the dismissal of his appeal. On Feb. 28, 1983, the heirs of Jomoc executed another extrajudicial settlement with absolute sale in favor of intervenors Kang and King. Maura So demanded from the Jomoc family the execution of a final deed of conveyance. They ignored the demand. Thus, Maura So sued Jomoc heirs for specific performance to compel them to execute and deliver the proper registrable deed of sale over the lot (Civil Case 8983). She then filed a notice of *lis pendens* with the Register of Deeds on Feb. 28, 1983. On the same date, allegedly upon Jomoc's belief that Maura So had backed out from the transaction, the Jomocs executed the other extrajudicial settlement with sale of registered land in favor of the spouses Lim for P200,000 part of which amount was allegedly intended to be returned to Maura So as reimbursement. The spouses Lim, however, registered their settlement and sale only on Apr. 27, 1983. The Jomocs as defendants, and the spouses Lim as intervenors, alleged that complainant Maura So backed out as evidenced by an oral testimony that she did so in a conference with Jomoc's lawyers where she expressed frustration in evicting squatters who demanded large sums as a condition for vacating. They alleged the lack of signatures of four of the heirs of Jomoc and Maura So herself as well as the lack of notarization. The lower court, finding that there was no sufficient evidence to show Mariano So's withdrawal from the sale, concluded that: (1) the case is one of double sale; (2) the spouses-intervenors Mariano and Maura So are registrants in bad faith who registered their deed

of sale long after the notice of *lis pendens* of Civil Case 8993 was recorded. The Court of Appeals (CA) affirmed the trial court's decision, except for the award of moral and exemplary damages, attorney's fees and expenses for litigation.

HELD: The Supreme Court affirmed the CA's decision and held that Lim spouses' allegation that the contract of sale by Maria Jomoc with Maura So is enforceable under the Statute of Frauds, is without merit. Lim spouses do not deny the existence of Exhibit A, including its terms and contents, notwithstanding the incompleteness in form. The meeting of the minds and the delivery of sums as partial payment is admitted by both parties to the agreement. Hence, there was already a valid and existing contract, not merely perfected as the trial court saw it, but partly executed. It is of no moment whether or not it is enforceable under the Statute of Frauds, which rule is not applicable because of partial payment of the vendee's obligation and its acceptance by the vendors-heirs. The contract of sale of real property even if not complete in form, so long as the essential requisites of consent of the contracting parties, object and cause of the obligation concur and they were clearly established to be present, is valid and effective as between the parties. Under Art. 1357 of the Civil Code, its enforceability is recognized as each contracting party is granted the right to compel the other to execute the proper public instrument so that the valid contract of sale of registered land can be duly registered and can bind third persons. Maura So correctly exercised such right simultaneously with a prayer for the enforcement of the contract in one complaint. She did not abandon her intention of purchasing the subject lot. The contracting parties to Exhibit A agreed that "the consideration of P300,000 or whatever balance remains after deducting the advanced payments thereon, shall be paid upon the termination of (Mariano So's) appeal in the case involving the property in question. Even if the sums paid by Maura So were intended to expedite the dismissal of Mariano So's appeal, such payment only indicate interest in acquiring the lot. In addition, the claim by the Lim spouses that the payments were for the gathering of the several heirs from far places to sign Exhibit A confirms Maura So's continuing interest. The terms of Exhibit A and the actual intention of the parties are clear and no reform requiring parol evidence is being sought to elucidate the intention further. The

oral evidence offered by the Lim spouses to show a subsequent refusal to proceed with the sale cannot be considered to reverse the express intention in the contract.

**Lim v. CA
68 SCAD 679
(1996)**

A contract of agency to sell on commission basis does not belong to any of the three categories mentioned in Arts. 1357 and 1358 of the Civil Code and Art. 1403 of the Statute of Frauds; hence, it is valid and enforceable in whatever form it may be entered into.

Art. 1358. The following must appear in a public document:

(1) Acts and contracts which have for their object the creation, transmission, modification or extinguishment of real rights over immovable property; sales of real property or of an interest therein are governed by Articles 1403, No. 2, and 1405;

(2) The cession, repudiation or renunciation of hereditary rights or of those of the conjugal partnership of gains;

(3) The power to administer property, or any other power which has for its object an act appearing or which should appear in a public document, or should prejudice a third person;

(4) The cession of actions or rights proceeding from an act appearing in a public document.

All other contracts where the amount involved exceeds five hundred pesos must appear in writing, even a private one. But sales of goods, chattels or things in action are governed by Articles 1403, No. 2 and 1405.

COMMENT:

(1) Form for Convenience

The necessity for the *public document* in the contracts enumerated here is only for convenience, not for validity or

enforceability. (*Thunga Chui v. Que Bentec*, 2 Phil. 561; *Del Castillo v. Escarella*, 26 Phil. 406 and *Guerrero v. Miguel*, 10 Phil. 52).

(NOTE: The ruling in *Que Yong Keng v. Tan Quico*, 14 Phil. 173, holding the contrary rule is WRONG.)

Fule v. CA
GR 112212, Mar. 2, 1998

Article 1358, which requires the embodiment of certain contracts in a public instrument, is only for convenience, and registration of the instrument only adversely affects third parties.

Formal requirements are for the benefit of third parties. Non-compliance therewith does not adversely affect the validity of the contract nor the contractual rights and obligations of the parties thereunder.

(2) Problem

A loan was contracted orally. If the amount is P800, may the lender recover the sum lent?

ANS.: Yes, because although the law says that contracts involving more than P500 must appear in writing, *even a private one*, still this requirement is only for convenience, not for validity. (*Thunga Chui v. Que Bentec*, 2 Phil. 561 provides the correct rule and not *Que Yong Keng v. Tan Quico*, 14 Phil. 173, which provides the *wrong rule*.)

[NOTE: All the lender has to do here is to avail himself of Art. 1357, the right to compel the execution of the needed instrument. Moreover, “this right may be exercised simultaneously with the action upon the contract.” (*Art. 1357*).]

[NOTE: A stipulation, however, to pay interest on loans must be in writing. If not, Art. 1357 cannot be availed of. If not in writing, the stipulation as to interest is VOID, but the loan itself is VALID. (*See Art. 1956*).]

[NOTE: In the case of *Segunda Pornellosa, et al. v. The Land Tenure Administration, et al.*, L-14040, Jan. 31, 1961, the Supreme Court *surprisingly* held, *contrary to previous cases*,

that while a sale in a PRIVATE document of a *lot* and the *house* constructed thereon is valid upon the parties with respect to the sale of the *house* erected thereon, yet it is *not sufficient* to convey title or any right to the residential lot in litigation. Citing Art. 1358(1) of the Civil Code, the Court held that acts and contracts which have for their object the creation, transmission, modification or extinguishment of real rights over immovable property must appear in a public document. It should be observed however that in this case, the ruling adverted to may be considered a mere OBITER, since under the facts of the case the seller was NOT the owner of the property involved.]

(3) Presumption of the Validity of a Public Instrument

Cabaliw and Sadorra v. Sadorra, et al. L-25650, Jun. 11, 1975

The principle that to destroy the validity of an existing public document, strong and convincing evidence is necessary, operates only when the action is brought by one party against the other to impugn the contract, and not when the suit is instituted by a third person, not a party to the contract, but precisely the victim of it.

Castillo v. Castillo L-18238, Jan. 22, 1980

A recital in a public instrument celebrated with all the legal formalities under the safeguard of a notarial certificate is evidence against the parties and a high degree of proof is necessary to overcome the legal presumption that such recital is true. (*See Valencia v. Tantoco, et al.*, 99 Phil. 824).

Chapter 4

REFORMATION OF INSTRUMENTS (n)

INTRODUCTORY COMMENT:

(1) 'Reformation' Defined

"Reformation is that remedy in equity by means of which a written instrument is made or construed so as to express or conform to the real intention of the parties when some error or mistake has been committed." (53 *Corpus Juris* 906).

(2) Reason for Reformation

"Equity orders the reformation of an instrument in order that the *true intention* of the contracting parties may be expressed. The courts *do not* attempt to make another contract for the parties. The *rationale* of the doctrine is that it would be unjust and inequitable to allow the enforcement of a written instrument which does not reflect or disclose the real meeting of the minds of the parties. The rigor of the legalistic rule that a written instrument should be the final and inflexible criterion and measure of the rights and obligations of the contracting parties is thus tempered to forestall the effects of mistake, fraud, inequitable conduct or accident." (*Report of the Code Commission*, p. 56).

Art. 1359. When, there having been a meeting of the minds of the parties to a contract, their true intention is not expressed in the instrument purporting to embody the agreement, by reason of mistake, fraud, inequitable conduct or accident, one of the parties may ask for the reformation of the instrument to the end that such true intention may be expressed.

If mistake, fraud, inequitable conduct, or accident has prevented a meeting of the minds of the parties, the proper remedy is not reformation of the instrument but annulment of the contract.

COMMENT:

(1) Distinctions Between ‘Reformation’ and ‘Annulment’

- (a) Where there has been a *meeting* of the minds, but there is mistake, fraud, inequitable conduct or accident in the contract as written, the remedy is REFORMATION. When there has been no meeting of the minds, because of vitiated consent, the proper remedy is ANNULMENT.

Example:

If the seller was selling for P1,000,000 but the buyer thought he was buying for P500,000 and the contract states P1,000,000, there has been no *meeting* of the minds and the remedy is *annulment*; but if both agreed on P500,000 and the contract as written states P1,000,000, the remedy is *reformation*, because here, there has been a meeting of the minds.

- (b) Reformation does not invalidate a contract; annulment invalidates a contract.

(2) Requisites for the Action for Reformation

- (a) There must be a meeting of the minds.
- (b) The true intention is *not* expressed in the instrument.

**Sarming v. Dy
GR 133643, Jun. 6, 2002**

All of the requisites regarding an action for reformation of instrument provided under Art. 1359 of the Civil Code, are present in the instant case. Thus:

There was a meeting of the minds between the parties to the contract but the deed did not express the true intention of the parties due to mistake in the designation

of the lot subject of the deed. There is no dispute as to the intention of the parties to sell the land to Alejandra Delfino but there was a mistake as to the designation of the lot intended to be sold as stated in the Settlement of Estate and Sale.

- (c) There must be clear and convincing proof thereof.

[NOTE: Mere preponderance of evidence here would not be sufficient. (*Gonzales Mondragon v. Santos*, 48 O.G. 560).]

- (d) It must be brought within the proper prescriptive period.
- (e) The document must *not* refer to a simple unconditional donation *inter vivos* (Art. 1366), or to wills (Art. 1366), or to a contract where the real agreement is void. (Art. 1366).

BA Finance Corp. v. IAC & Rene Tan
GR 76497, Jan. 20, 1993

In the case at bar, there is no dispute that there was a meeting of the minds with respect to the arrangement whereby the private respondent borrows money from the petitioner and the subject car serves as security for the payment of the loaned amount. The private respondent had insisted that what he merely intended in contracting with the petitioner was to secure a loan with his Volkswagen Sedan as collateral. Upon the other hand, the petitioner, by virtue of the private respondent's loan application, prepared the necessary papers which included a Deed of Absolute Sale of the subject car in its favor in order that its legal ownership shall serve as the security for the repayment of the amount being loaned by the private respondent thru the payment of monthly rentals under a Contract of Lease which the latter duly signed.

In order that an action for reformation may prosper, there must be a meeting of the minds of the parties to a contract, but their true intention is not expressed therein by reason of mistake, fraud, inequitable conduct or accident. Notwithstanding, the private respondent has not succeeded in proving the above circumstances to avail of the remedy of reformation. In attempting to prove his allegation that a contract of simple loan was intended, the

private respondent pointed out the discrepancy between the purchase price of P20,000 as indicated in the Deed of Absolute Sale and the amount of P15,913.06 actually received by him as evidenced by a check dated Oct. 22, 1976 issued to Martina Industries by the petitioner with regard to the financing arrangement agreed upon by them. Such discrepancy dismisses the petitioner's position that he had agreed to sell his car to the petitioner; hence, the basis for the *financing lease contract* as claimed by the petitioner is not existent. For all intents and purposes, a "financing lease" may be seen to be a contract *sui generis*, possessing some but not necessarily all of the elements of an ordinary or civil law lease. Thus, legal title to the equipment leased is lodged in the financial lessor. The financial lessee is entitled to the possession and use of the leased equipment. At the same time, the financial lessee is obligated to make periodic payments denominated as lease rentals, which enable the financial lessor to recover the purchase price of the equipment which had been paid to the supplier thereof.

(3) No New Contract Is Made

Cosio v. Palileo L-18452, May 31, 1965

In reforming instruments, courts do *not* make another contract for the parties. They merely inquire into the *intention* of the parties and having found it, reform the written instrument (not the content), in order that it may express the real intention of the parties.

(4) Reformation May Still Prosper Even If Property Involved Is Already Mortgaged by Buyer to a Third Person

Jayme, et al. v. Alampay, et al. L-39592, Jan. 28, 1975

FACTS: A married couple entered into a contract of mortgage, but the instrument signed was one of absolute sale, so an action for reformation was brought. A motion to dismiss was filed on the ground that the property involved was already actually

mortgaged by the ostensible buyer to a third person. *Issue:* Can the action for reformation still prosper despite the existence of the mortgage in favor of a third person?

HELD: Yes, the action for reformation may still prosper despite the mortgage in favor of the third person. If the plaintiffs should succeed in having the contract reformed, and thus get back their property (by paying the mortgage debt), the property would be theirs, subject only to the mortgage rights of the third person, or it may even be possible that the defendant would be ordered by the Court to free the property from the mortgage before giving the property to the plaintiffs. The motion to dismiss should be denied.

Art. 1360. The principles of the general law on the reformation of instruments are hereby adopted insofar as they are not in conflict with the provisions of this Code.

COMMENT:

Rule in Case of Conflict

In case of conflict between the Civil Code and the principles of the general law on reformation, the former prevails. The latter will have only suppletory effect.

Art. 1361. When a mutual mistake of the parties causes the failure of the instrument to disclose their real agreement, said instrument may be reformed.

COMMENT:

(1) When Reformation May Be Asked Because of Mutual Mistake

- (a) Under this Article, the mistake must be mutual.
- (b) The mistake may be *unilateral* under the conditions set forth in Arts. 1362 and 1363 of the Civil Code.
- (c) The mistake must be of *fact* — usually. Therefore, generally an error of law is not enough. (*Bank of the P.I. v. Fidelity & Surety Co. of the P.I.*, 51 Phil. 57).

(2) Example

A sold to B orally a house at 16 San Isidro, Malate. In the written public document, both forgot the true number of the house and instead wrote on the contract “No. 18 San Isidro, Malate.” Here, reformation of the instrument is proper.

(3) Another Example

A made a check in favor of B. C wrote in the note “I guarantee that A will not suffer any harm.” B now seeks to reform the instrument saying that the note should state “I guarantee that B will not suffer any harm” and that the mistake was mutual. But B was not able to *satisfactorily* prove that there was such a mistake. Should the instrument be reformed?

ANS.: No, the instrument should not be reformed. The plaintiff Bank (B) has not established a mutual mistake by proof of the clearest and most satisfactory character constituting more than a preponderance of evidence. To justify the reformation of a written instrument upon the ground of mistake, the concurrence of three things are necessary:

First, that the mistake should be of a fact;

Second, that the mistake should be proved by clear and convincing evidence; and

Third, that the mistake should be common to both parties to the instrument (*where mutual mistake is alleged*). (*Bank of the Philippine Islands v. Fidelity and Surety Company of the P.I.*, 51 Phil. 57).

(4) Case

**San Miguel Brewery v.
La Union and Rock Insurance Co.
40 Phil. 674**

FACTS: In the preparatory negotiations for a contract of insurance, it was agreed that the interest of *both* the *owner* and the *mortgagee* of the property should be protected. However, as written, because of mistake, only the interests of the mortgagee

were protected. *Issue*: Does the court have the right to reform the contract?

HELD: Yes, because of the mutual error.

Art. 1362. If one party was mistaken and the other acted fraudulently or inequitably in such a way that the instrument does not show their true intention, the former may ask for the reformation of the instrument.

COMMENT:

(1) Unilateral Mistake

In this Article, the mistake is *unilateral* but the other party acted *fraudulently or inequitably*.

(2) Example

A agreed with B that A would be loaned P10,000,000 by B. In the contract signed by A and B, it was stated that A was selling his house to B for said amount. A signed the contract in the belief that it was really a contract of loan. Who, if any, may ask for the reformation of the instrument if B had acted fraudulently?

ANS.: A may ask for the reformation of the instrument because after the meeting of the minds, one party (B) acted fraudulently or inequitably in such a way that the contract does not show their real intention. In such a case, the law provides that the person who acted by mistake may ask for the reformation of the instrument.

(3) Case

**Ong Chua v. Carr, et al.
53 Phil. 975**

FACTS: Teck sold his land to Ong with the right to repurchase within 4 years. Ong sold the land to Carr with the understanding that Carr was buying it, subject to the right to repurchase on the part of Teck. At that time, Carr did not have

enough money. So Carr asked for a loan from an Association. The Association offered to give a loan provided Carr could offer, as security, land of which he was the *absolute* owner, that is, land which would not be subject for example to repurchase. So Carr began to think. With the help of a lawyer who drafted the deed, Carr and Ong (who did not know English) signed a contract in which Carr was made out to be the absolute owner of the land, and the words regarding the “right to repurchase” omitted. Later Teck was repurchasing the property from Ong, and Ong demanded the reconveyance of the property from Carr. Carr refused on the ground that he (Carr) was the absolute owner of the land. Hence, Ong brought this action against Carr. *Issue*: May the contract be reformed? If so, may Ong now demand the land from Carr so that it would be resold to Teck?

HELD: Yes, the contract may be reformed because “if one party was mistaken and the other acted fraudulently or inequitably in such a way that the instrument does not show their true intention, the former may ask for the reformation of the instrument.” (Art. 1362, *Civil Code*). It follows, therefore, that Ong may now demand the reconveyance of the property to him so that the land may be repurchased by Teck.

Art. 1363. When one party was mistaken and the other knew or believed that the instrument did not state their real agreement, but concealed that fact from the former, the instrument may be reformed.

COMMENT:

Unilateral Mistake Also

- (a) Here again, the mistake is *unilateral* but the other party is guilty of concealment.
- (b) Only the party in good faith can ask for reformation.

Art. 1364. When through the ignorance, lack of skill, negligence or bad faith on the part of the person drafting the instrument or of the clerk or typist, the instrument does not express the true intention of the parties, the courts may order that the instrument be reformed.

COMMENT:**(1) Failure to Convey the True Intent**

The court may order the reformation of the instrument if the instrument does not convey the true intention of the parties because of the:

- (a) ignorance
- (b) lack of skill
- (c) bad faith of
 - 1) the drafter of the instrument
 - 2) or the clerk
 - 3) or the typist.

(2) Case

**Manila Engineering Co. v.
Cranston and Heacock
45 Phil. 128**

FACTS: In a contract, although the original draft read in dollars, the contract was made out in pesos through the typist's fault. *Issue:* May the instrument be reformed?

HELD: Yes. "It conclusively appears from the collateral facts and surrounding circumstances that it was intended that the *dollar* sign was to be used and that defendant knew or in the ordinary course of business should have known that a mistake was made. The contract will be reformed and the dollar sign substituted for the peso sign."

Art. 1365. If two parties agree upon the mortgage or pledge of real or personal property, but the instrument states that the property is sold absolutely or with a right of repurchase, reformation of the instrument is proper.

COMMENT:**(1) Intent to Have a Mortgage or Pledge**

Example:

B wanted to borrow from *L*, so he offered by way of mortgage his land as security. Both parties agreed on this point but the

contract as drafted contained an *absolute sale*. May the instrument be reformed?

ANS.: Yes; otherwise, the true intention of the parties would be frustrated.

(2) How to Judge the Parties' Intent

The intention of the parties can be judged from their contemporaneous and subsequent acts. (*Velasquez v. Teodoro*, 46 Phil. 757).

Art. 1366. There shall be no reformation in the following cases:

(1) Simple donations *inter vivos* wherein no condition is imposed;

(2) Will;

(3) When the real agreement is void.

COMMENT:

(1) When Reformation Is Not Allowed

The Article gives 3 instances when reformation is not allowed.

(2) Reason for Instance No. 1 (Simple Donations)

Donations are essentially acts of pure liberality. However, if the donation is conditional, reformation may be resorted to so that the real or true conditions intended by the donor might be brought out. In case the donation is an onerous one, reformation is very much in order inasmuch as in this case, said donation would partake very much of the nature of contracts.

(3) Reason for Instance No. 2 (Wills)

The making of a will is strictly a *personal act* (Art. 784, *Civil Code*) which is free. (Art. 839, *Civil Code*). Moreover, a will may be revoked at any time. (Art. 828, *Civil Code*).

(NOTE: However, after the death of the testator, *errors or imperfections in descriptions may be corrected under Art. 789 of the Civil Code, but not the manner of property disposal.*)

(4) Reason for Instance No. 3 (Void Agreement)

Reformation is not allowed in case the real agreement is void because such a procedure would be useless. Once reformation is made, the new instrument would be void precisely because the true agreement and intention are void.

Art. 1367. When one of the parties has brought an action to enforce the instrument he cannot subsequently ask for its reformation.

COMMENT:**(1) Effect of an Action to Enforce the Instrument**

- (a) This Article presents another instance when reformation cannot prosper.
- (b) Basis is *estoppel, waiver or ratification*.

(2) Example

A sold B a house. A fraudulently made the contract one of mortgage instead of sale. Both signed the contract of mortgage, with B believing all the time that it was a contract of sale. B, therefore, has the right to bring an action for the reformation of the instrument; but if B brings an action to foreclose the mortgage, he is by said action enforcing the instrument. He cannot, therefore, subsequently ask for the reformation of the instrument to make it one of sale.

Art. 1368. Reformation may be ordered at the instance of either party or his successors in interest, if the mistake was mutual; otherwise, upon petition of the injured party, or his heirs and assigns.

COMMENT:**(1) Plaintiffs in Action for Reformation**

- (a) If the mistake is *mutual*, either party or his successors in interest;

- (b) In all other cases:
 - 1) the injured party;
 - 2) his heirs and assigns.

(2) Problem

A and B agreed on a certain contract, but A fraudulently made a document reciting another kind of contract. Later, both A and B died.

- (a) May the son of B bring an action to reform the instrument?
- (b) May the son of A bring an action to reform the instrument?

ANS.:

- 1) Yes, the son of B may bring an action to reform the instrument because he is the heir of the injured party.
- 2) No, the son of A cannot bring a successful action to reform the instrument inasmuch as it was the father who caused the fraud.

Query: But suppose the son of A wanted to correct the fraud made by his father?

ANS.: This is all right but in such a case, no court action is needed anymore, since both parties can agree to reform the instrument by themselves.

(3) What Complaint Must Allege

Before reformation can be granted, the complaint must allege:

- (a) that the instrument to be reformed does *not* express the real agreement or intention of the parties (*Ongsiako, et al. v. Ongsiako, et al.*, L-7510, Mar. 30, 1957);
- (b) what the real agreement or intention was. (*Garcia v. Bisaya, et al.*, 97 Phil. 609).

[NOTE:

- 1) It is not the function of the remedy of reformation to make a new agreement, but to establish and perpetuate the true existing one. (*23 RCL, par. 4, p. 311*).
- 2) Moreover, courts do *not* reform instruments merely for the sake of reforming them, but only to enable some party to assert rights under them as reformed. (*23 RCL, par. 2*).]

(4) Prescriptive Period for Reformation of a Contract

Antonio Jayme, et al. v. Hon. Nestor Alampay
L-39592, Jan. 28, 1975

The period of prescription for the reformation of a contract (such as one ostensibly an absolute sale but actually a mortgage) is ten (10) years.

Art. 1369. The procedure for the reformation of instruments shall be governed by Rules of Court to be promulgated by the Supreme Court.

COMMENT:**Procedural Rules**

These procedural rules are supposed to be promulgated by the Supreme Court.

Chapter 5

INTERPRETATION OF CONTRACTS

Art. 1370. If the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulations shall control.

If the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former.

COMMENT:

(1) Reason for Interpretation of Contracts

What is the use of interpreting a contract? Should we not just *apply* the terms of the contract? It is true we must apply the terms of the contract, but only when they are so clear that there is no doubt regarding the intention of the contracting parties. But in other cases, we should apply the rules of interpretation.

(2) Rule in Case of Conflict

In case of conflict between the words of the contract and the evident intention of the parties, which one must prevail?

ANS.: The intention must prevail. "Let us interpret not by the letter that killeth but by the spirit that giveth life." "If the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former." (*2nd paragraph, Art. 1370, Civil Code*).

Where the terms and provisions thereof are clear and leave no doubt as to the intention of the contracting parties, the literal meaning of its stipulation shall control. (*R & M General Merchandise, Inc. v. CA, GR 144189, Oct. 5, 2001*).

(3) Cases**Aniversario v. Ternate
10 Phil. 53**

FACTS: A document reads as follows: “Received from Doña Maria Aniversario the sum of P510.00, in payment of the price of a *white horse purchased* at San Juan de Bocoboc, Manila, Nov. 25, 1902. (SGD). FLORENTINO TERNATE.” *Issue:* Was the money paid for a horse *already purchased* or for a horse still to be *purchased*?

HELD: The money was paid for a horse *already purchased*. The document “exhibited by the plaintiff in support of her action does not prove the allegation of the complaint but those of the answer of the defendant, to the effect that the latter, on the abovementioned date, received the sum of P510.00, *not* to purchase a horse at that time, as contended by the plaintiff, but in payment of the price of a white horse *already bought*, as alleged by the defendant. This construction by the lower court is in conformity with the provisions of Art. 1281 of the Civil Code (*now Art. 1370 of the new Civil Code*) which says that “if the terms of a contract are clear and leave no doubt as to the intention of the contracting parties, the literal sense of its provisions shall be observed.”

**Baluran v. Navarro
79 SCRA 309**

If two parties intend to merely transfer to each other the material possession of their respective parcels of land, no barter is presumed.

**Francisco J. Nicolas v.
The Reparations Commission and Pedro Pastoral
L-28649, May 21, 1975**

FACTS: In a written contract, the parties agreed that “all legal actions arising out of this contract. . . *may* be brought in and submitted to the jurisdiction of the proper courts in the City of Manila.” May the parties sue in courts *outside* of Manila, as in the Court where the defendant or the plaintiff resides at the election of the plaintiff?

HELD: Yes, the parties may sue elsewhere — the clause in question being permissive only in view of the use of the word “may.” Venue (or the place of trial) in personal actions is fixed for the convenience of the parties and to promote the ends of justice. To confine the venue here to Manila would not serve the interests of justice. In a similar case previously decided, *re* the stipulation that the parties *consent to sue or be sued* in Manila, the Court held that such stipulation did not make Manila the obligatory venue. The stipulation only ADDS Manila to the different possible venues.

(*NOTE:* It would have been different if the parties had categorically stated in the contract that Manila would be the ONLY venue.)

Pay v. Vda. de Palanca
L-29900, Jun. 28, 1974

FACTS: A promissory note stated that it was payable upon receipt of the debtor of cash payment from a certain estate, or upon demand. *Issue:* Is this obligation demandable at once?

HELD: Yes, because of the clear import of the words “or upon demand.”

Abella v. Gonzaga
56 Phil. 132

FACTS: A and B entered into a so-called contract of lease, whereby B would pay certain regular amounts as “rentals” and at the end of the “lease,” B would become the *absolute* owner of the property. *Issue:* Is this really a *lease* or a *sale in installments*?

HELD: This contract is really a sale in *installments* for such was the evident intention of the contracting parties.

“Although in the contract, Exhibit A, the usual words ‘lease,’ ‘lessee,’ and ‘lessor’ were employed, that is not obstacle to holding, as the court hereby holds, that said contract was a sale on installments, for such was the *evident intention* of the parties in entering into said contract.”

[*NOTE:* “Sellers desirous of making conditional sales of their goods, but who do not wish openly to make a bargain in

that form, for one reason or another, have frequently resorted to the device of making contracts in the form of leases either with options to the buyer to purchase for a small consideration at the end of the term, provided the so-called rent has been duly paid, or with stipulations that if the rent through the term is paid, *title shall thereupon vest in the lessee*. It is obvious that such transactions are leases only in name. The so-called rent must necessarily be regarded as payment of the price in installments, since due payment of the agreed amount results, by the terms of the bargain, in the transfer of title to the lessee.” (*Vda. de Jose v. Veloso Barrueco*, 67 Phil. 191).]

Aquino v. Deala
63 Phil. 582

FACTS: A needed money badly. So he asked B for a loan, offering his (A's) house as security. B did not want to lend with a mortgage as security, but he offered to buy the house, with the right of repurchase on the part of A. The money paid was a small sum, considering the value of the house. When the period for repurchase ended, and A had not yet redeemed the property, the title of absolute ownership was vested in B, the vendee *a retro* (the buyer in a sale with the right of repurchase). B thereupon asked A to leave the house. A refused. Hence, B brought this action to oust A. *Issue:* Is the contract really a sale with the right of repurchase (*pacto de retro*) or is it really a mortgage (*an equitable mortgage*)?

Importance of the issue: If it is really a *pacto de retro* contract, B is now the owner of the property because the house was not redeemed by A during the period for repurchase, and therefore A should be ousted. On the other hand, if the contract should be interpreted as an equitable mortgage, ownership has not yet been vested on B because foreclosure proceedings should still be done, and therefore A should still remain in the house.

HELD: Although apparently this is a *pacto de retro*, it really is an equitable mortgage, for considering the circumstances of the case, the purpose of the contract was really to make the house the security for the loan. There was no real intention here to sell the house.

Jimenez v. Bucoy
L-10221, Feb. 28, 1958

FACTS: A promissory note stated: "Received from Miss Pacifica Jimenez the total amount of P10,000 payable six months after the war, without interest." It was alleged that the note contained no express promise to pay. *Issue:* Was there a promise here?

HELD: Yes. Implicitly, there was a promise to pay the amount stated. An acknowledgment may become a promise by the addition of words by which a promise of payment is naturally implied, such as "payable."

Bijis v. Legaspi
L-10705, Mar. 30, 1960

FACTS: In a deed of sale, a certain lot No. 1357 was mentioned as the parcel sold, but both parties meant Lot No. 1155, and in fact buyer took possession of the latter with the knowledge of the seller.

HELD: Since the parties really meant Lot No. 1155, this should be considered the object of the contract.

Leonor v. Sycip
L-14220, Apr. 29, 1961

FACTS: A guarantor guaranteed the payment of rentals *already due* at the time the promise was made. *Issue:* Is he also responsible for *subsequent* rents?

HELD: Under the facts, it is clear he *never* had the obligations to pay the subsequent rents.

Fidel Teodoro v. Felix Macaraeg
and Court of Agrarian Relations
L-20700, Feb. 27, 1969

FACTS: A contract was denominated by the parties as a "Contract of Lease" but the real agreement was to create a "leasehold tenancy relation" (Agricultural). *Issue:* How should the contract be regarded?

HELD: The contract should be regarded as a “leasehold tenancy relation” because it is not the name given by the parties that controls but their real intent as gleaned from the purposes of the contract.

As distinguished from an ordinary lease contract, the following are the principal elements of a “leasehold tenancy contract or relation”:

- (a) The object is *agricultural land* leased for *agricultural production*;
- (b) The *size* of the landholding must be such that it is susceptible of *personal cultivation by a single person*, with the assistance from the members of his *immediate farm household*;
- (c) The tenant-lessee must *actually and personally till, cultivate or operate said land*, solely or with the aid of labor from his *immediate farm household*; and
- (d) The landlord-lessor, who is either the lawful owner or the legal possessor of the land, *leases* the same to the tenant-lessee for a price certain or ascertainable in an amount either of *money or produce*.

**Re Mario B. Chanliongco
79 SCRA 364**

If no beneficiary is named for the retirement benefits of a government employee, it is understood that the benefits will accrue to his estate.

**People v. Hon. Constante A. Ancheta, et al.
L-39993, May 19, 1975**

FACTS: One of the reasons given to disqualify Judge Constante A. Ancheta of the Criminal Circuit Court of Bulacan from hearing a particular case was the fact that he asked searching and minute questions of the witnesses in order to properly *interpret* their testimonies and *clear up ambiguities*. **Issue:** Is this a proper ground to disqualify said judge?

HELD: No, this would not be a proper ground for disqualification; otherwise, the discretion of a trial judge would be curtailed if minute and searching queries from the bench would be invested with a sinister significance. Litigants should remember that a judge is there precisely to ascertain the truth of the controversy before him. He enjoys a great deal of latitude therefore in examining witnesses within the limits of course of evidentiary rules. It is fitting and proper that a testimony should not be incomplete or obscure. After all, the judge is the arbiter, and he must be in a position to satisfy himself as to the respective merits of the claims of both parties. This is not to deny, of course, that there may be cases where an analysis of the questions asked will reveal bias.

GSIS v. CA
GR 52478, Oct. 30, 1986

FACTS: The mortgage contract provides that the rate of interest be 9% *per annum* compounded monthly, and any installment or amortization that remains due and unpaid shall bear interest at the rate of 9 1/2% per month. Later, because the loan was increased, an “Amendment of Real Estate Mortgage” was executed. The mortgagor claims that since the amendment contained no stipulation on compounded interest, since the amendment superseded the original contract, he should not be required to pay compounded interest on the arrearages.

HELD: There is no ambiguity in the terms and conditions of the amendment of the mortgage contract. The prior, contemporaneous and subsequent acts of the parties show that said amendment was never intended to completely supersede the original mortgage contract. *First*, the amendment recognizes the existence and effectivity of the previous contract. *Second*, nowhere in the amendment did the parties manifest their intention to supersede the original contract. *Third*, the amendment confirms and ratifies and considers in full force and effect the terms and conditions of the original mortgage and are made an integral part of the amendment. As a matter of policy, the GSIS imposes uniform terms and conditions for all its real estate loans, particularly with respect to compounding of interest.

U.P. College of Agriculture v. Gabriel
GR 70826, Oct. 12, 1987

FACTS: The sub-contract between the contractor and the sub-contractor states: "The terms of payment shall be on a monthly basis as per form accomplished and approved by the University of the Philippines College of Agriculture."

HELD: This stipulation is clear and leaves no doubt as to the intention of the contracting parties. It is essential that the works completed by the sub-contractor be approved before U.P. can be made liable under the sub-contract. It is of no moment that the sub-contractor wrote U.P. that the contractor had not yet paid all its obligations to the former. This does not necessarily mean approval of the sub-contractor's work.

Azcona v. Jamandre
GR 30597, Jun. 30, 1987

FACTS: The agreed yearly rental for an 80-hectare land was P7,200 for the three agricultural years beginning 1960, extendible at the lessee's option to more agricultural years up to 1965. The first annual rental was due on or before March 30, 1960. The lessee actually entered the premises only on Oct. 26, 1960 after payment of the sum of P7,000, which was acknowledged in a receipt which states: "The amount of SEVEN THOUSAND PESOS (P7,000), . . . as payment for the rental corresponding to crop year 1961-62" . . . to rental due on or before January 30, 1961, "as per contract." The lessor claims that the lessee defaulted in payment because the latter was P200 short of such rental, and concludes that the contract should be deemed cancelled. The trial court held that the P200 has been condoned.

HELD: The words "as per contract" found in the receipt of payment suggest that the parties were aware of the provisions of the agreement, which was described in detail elsewhere in the receipt. The rental stipulated in the contract was P7,200. The payment acknowledged in the receipt was P7,000 only. Yet no mention was made in the receipt of the discrepancy. On the contrary, the payment was acknowledged "as per contract." This means that the provisions of the contract were being maintained and respected except only for the reduction of the agreed rental.

The P200 was not condoned as held by the trial court. The requisites of condonation under Art. 1270 of the Civil Code are not present. What we see here is a mere reduction of the stipulated rental in consideration of the withdrawal of the leased premises of the 16 hectares where the lessor intended to graze his cattle. When the lessor accepted the receipt, he manifested his agreement on the reduction, which modified the lease contract as to the agreed consideration while leaving the other stipulations intact. That the amount of P7,000 was “payment in full” of the rental was adequately conveyed in the acknowledgment made by lessor that this was “payment for the rental corresponding to crop year 1961-62” and “corresponds to the rentals due on or before Jan. 30, 1961, as per contract.” The relative insignificance of the alleged balance is a paltry justification for annulling the contract for its supposed violation. If lessor is fussy enough to invoke it now, he would have fussed over it too in the receipt he willingly signed after accepting, without reservation, only P7,000. When the obligee accepts the performance, knowing its incompleteness or irregularity, and without expressing any protest or objection, the obligation is deemed fully complied with.

**Simeon Del Rosario v. Shell Co.
of the Phils., Ltd.
L-28776, Aug. 19, 1988**

If provided for in a contract, should business rentals be adjusted in relation to the peso value *vis-a-vis* the U.S. dollar under “devaluation” or “appreciation” (opposite of “depreciation”)?

Yes. Any resultant decrease (or increase) in the par value of the currency is precisely the situation or event contemplated by the parties in their contract; accordingly, an upward (or downward) revision of the rent is called for.

[*NOTA BENE*: It is interesting to note in the abovesited case that the contract at bar used the alternative term “appreciation.” Any dictionary defines appreciation as a rise in value. Now if according to said contract there shall be an adjustment of the monthly rental in the event of a rise in the value of the Philippine currency, why should there be no similar adjustment in the event of a decrease in value of the same currency?]

**The Manila Banking Corp. v. Anastacio
Teodoro, Jr. and Grace Anna Teodoro
GR 53955, Jan. 13, 1989**

The character of the transaction between the parties is to be determined by their intention, regardless of what language was used or what the form of transfer was. If it was intended to secure the payment of money, it must be construed as a pledge. However, even though a transfer, if regarded by itself, appears to have been absolute, its object and character might still be qualified and explained by a contemporaneous writing declaring it to have been a deposit of the property as collateral security.

It has been said that a transfer of property by the debtor to a creditor, even if sufficient on its face to make an absolute conveyance, should be treated as a pledge if the debt continues in existence and is not discharged by the transfer, and that accordingly, the use of the terms ordinarily importing conveyance of absolute ownership will not be given that effect in such a transaction if they are also commonly used in pledges and mortgages and, therefore, do not unqualifiedly indicate a transfer of absolute ownership, in the absence of clear and ambiguous language or other circumstances excluding an intent to pledge.

Definitely, the assignment of the receivables did not result from a sales transaction. It cannot be said to have been constituted by virtue of a *dation* in payment for appellant's loans with the bank evidenced by promissory notes which are the subject of the suit for collection. At the time the deed of assignment was executed, said loans were non-existent yet. At most, it was a *dation* in payment for P10,000, the amount of credit from appellee bank indicated in the deed of assignment. At the time the assignment was executed, there was no obligation to be extinguished except the amount of P10,000. Moreover, in order that an obligation may be extinguished by another which substitutes the same, it is imperative that it is so declared in unequivocal terms, or that the old and the new obligations be on every point incompatible with each other. Obviously, the deed of assignment was intended as collateral security for the bank loans of appellants, as a continuing guaranty for whatever sums would be owing by defendants to plaintiff.

**Filoil Marketing Corp. (now Petrophil Corp.)
v. IAC and Josefina Alberto De Pabalan
GR 67115, Jan. 20, 1989**

Corporations and businessmen should exercise more fairness in dealing with ordinary persons, especially if they do not have the assistance and advice of counsel. Such persons are not likely to read the fine print in a contract or to understand the instruments they are signing unless they are properly informed of the implications of their unsuspecting and heedless acts.

This is not to say that such instruments are *per se* invalid without such explanation. What it simply means is that in proper cases, contracts should be read in the light of the layman's understanding of their esoteric legal language, that they may not ensnare him, because of his trusting lack of caution, in their intricate stipulations.

**Baliwag Transit v. CA, et al.
GR 80447, Jan. 31, 1989**

The phraseology "any and all claims or causes of action" is broad enough to include all damages that may accrue to the injured party arising from the unfortunate accident.

**Lucio Tan Alim v. CA
GR 93213, Aug. 9, 1991**

FACTS: Pacific Coast Timber Products, Inc., as lessor, entered into a contract of lease with option to buy, with Lucio Tan Alim, as lessee, for a term of 15 months over a unit of tractor at a monthly rental of P10,000, subject to the stipulation that after payment of five months, the lessee is given the option to buy the equipment at P15,000, in which event the rental paid shall be considered as part of the consideration and that the equipment has to remain at the lessee's jobsite. However, upon its delivery, the tractor was discovered to be defective. So Alim told Pacific's manager of such fact, relaying also the need for the tractor's reconditioning or replacement with another unit in good running condition and the immediate repair thereof as may be arranged by him with the Manila Office. Later, the parties amended the lease contract, with Alim's obligation to execute a

Deed of Chattel Mortgage for his three motor vehicles in favor of Pacific to guarantee his undertaking in the amended lease contract. Pacific's lawyer informed Alim that under the amended contract wherein payments of rentals started in Aug. 1977, the latter failed to pay rentals for seven months in the amount of P70,000, for which reason the contract of lease, as well as the option to buy, are automatically terminated. The lawyer also sent a notice of default in obligation secured by the Chattel Mortgage. However, the Sheriff returned, unsatisfied, a petition for extrajudicial foreclosure thereon. Thereafter, Pacific filed a complaint for recovery of possession with replevin (of a unit of tractor) due to Alim's refusal to pay the arrears and to deliver the equipment. Upon the filing of a bond by Pacific, in the sum of P300,000, the trial court issued a writ of replevin for the seizure and delivery of the property on Apr. 13, 1978. The Sheriff seized the tractor from Alim and turned it over to Pacific on Apr. 26, 1978. On the scheduled hearing of July 14, 1981, both parties failed to attend. Hence, the dismissal of the case. However, the order of dismissal was reconsidered upon explanation of the parties. The case was finally resolved in favor of Alim on Jul. 31, 1985 by the trial court. The decision was later modified by the trial court. Alim appealed, claiming damages because of the wrongful seizure of the tractor, but the Court of Appeals (CA) affirmed the trial court's decision, denying the claim for compensation. *Issue:* Whether or not the 15-month lease period had commenced from Aug. 1977 and expired in Oct. 1978.

HELD: Both the trial court and the CA are of the view that no amendment as to the duration of the contract of lease existed; that the contract expired as originally stipulated on Apr. 5, 1978 and that the tractor was seized by virtue of a writ of replevin on Aug. 16, 1978, the contract of lease had expired and the lessee Alim was consequently not entitled to damages. In the original contract, it was expressly stipulated that the lease shall be for a period of fifteen months and that the lessee is given an option to purchase the equipment for one hundred fifty thousand pesos, after Alim has completed and religiously paid the 5-month rentals which shall be considered as part of the payment of the consideration.

Upon the other hand, there is no provision in the amended contract as to the period of lease. Instead, it provides that "all

provisions of the original lease contract not amended by the foregoing provision shall remain in full force and effect. The alteration is evidently focused on the period for the right to exercise the option to buy. Originally, the period was five (5) months, unquestionably including the period from commencement of the original contract on Jan. 7, 1977, as specifically provided in paragraph 4 thereof, which states: "The monthly rentals of the equipment which on the date of the execution of this amendment of the original lease contract have not been paid shall be considered as paid obligation of lessee to lessor, the payment of which will be the subject of negotiation between lessor and lessee." The letter of Pacific's counsel, on which Alim heavily relied in his arguments in his favor, confirms the fact of non-extension of the lease agreement when he spoke of the commencement of the payment of the rentals, not on the commencement of the new period of lease. Inevitably, the courts cannot go beyond what appears in the documents submitted by the parties. Thus, there is no merit in Alim's allegation that the seizure was wrongful for which he must be compensated. The ownership or right of possession over the equipment belonged to Pacific at the time it was seized. The seizure of the equipment was ordered by the trial court for its restoration by means established in the laws of procedure. Thus, the requisites for the issuance of the writ of replevin have been satisfied. (*Sec. 2, Rule 60, Revised Rules of Court*).

Mojica v. Court of Appeals
GR 94247, Sept. 11, 1991

Contracts which are not ambiguous are to be interpreted according to their literal meaning and should not be interpreted beyond their obvious intendment. Thus, where the intent of the parties has been shown unmistakably with clarity by the language used, the literal meaning shall control. Correspondingly, stipulations in the mortgage document constitute the law between the parties, which must be complied with faithfully.

Republic v. Sandiganbayan
GR 9067, Nov. 5, 1991

When the words of a contract are plain and readily understandable, there is no room for construction. Where the parties'

agreement has been reduced to writing, the rule applies that their agreement is to be considered as containing all such terms and there can be between the parties and their successors-in-interest no evidence of the terms of the agreement other than the contents of the writing.

**Oil & Natural Gas Commission v.
CA & Pacific Cement Co., Inc.
GR 114323, Jul. 23, 1998**

The doctrine of *noscitur a sociis*, although a rule in the construction of statutes, is equally applicable in the ascertainment of the meaning and scope of vague contractual stipulations.

According to the maxim, where a particular word or phrase is ambiguous in itself or is equally susceptible of various meanings, its correct construction may be made clear and specific by considering the company of the words in which it is found or with which it is associated, or stated differently, its obscurity or doubt may be reviewed by reference to associated words.

**Petrophil Corp. v. CA
GR 122796, Dec. 10, 2001**

FACTS: The contract provided for causes for termination, although it also stated that the contract was for an indefinite term subject to the right of petitioner to terminate it any time after a written notice of 30 days.

HELD: The contract clearly provided for two ways of terminating the contract, and, one mode does not exclude the other.

When the language of a contract is clear, it requires no interpretation. The finding that the termination of the contract was “for cause,” is immaterial. When petitioner terminated the contract “without cause,” it was required only to give private respondent a 30-day prior written notice, which it did in this case.

Art. 1371. In order to judge the intention of the contracting parties, their contemporaneous and subsequent acts shall be principally considered.

COMMENT:**(1) How to Judge Intent of the Parties**

- (a) If the parties have themselves placed an interpretation to the terms of their contract, such interpretation must in general be followed. (*Valdez v. Sibal*, 46 Phil. 930).
- (b) The contract of the parties may result in estoppel. (*Arts. 1431-1439, Civil Code*).
- (c) The courts may consider the relations existing between the parties and the purpose of the contract, particularly when it was made in good faith between mutual *friends*. (*Kidwell v. Cartes*, 43 Phil. 953).

(2) Cases**Manila Electric Co. v. Commissioners
30 Phil. 387**

FACTS: When the Meralco obtained a franchise from the City of Manila, free transportation was granted in the franchise to employees of the City of Manila “wearing official badges.” The question to determine is: What should be the proper interpretation of “wearing,” wearing so that it could be seen, or wearing the badge, without the badge being seen? Or should the term include both? To properly solve the question, the Supreme Court had to look into the actions of the contracting parties at the time of and subsequent to the granting of the franchise. It was proved to the satisfaction of the court that for *nine years* the parties interpreted the phrase to mean “the wearing of the official badges so that they could be seen.”

HELD: Such interpretation of the parties should be the interpretation by the court, because “the courts are NOT at liberty to adopt a construction opposed to that which the parties have placed on their contract.”

**Aurora Capulong v. Court of Appeals
L-61337, Jun. 29, 1984**

If two documents are executed on the same day by the same parties — one being an absolute sale, and the other, an

option to repurchase, the two documents will be considered as one contract, namely, a sale with the right of redemption.

Weldon Construction Corp. v. CA
GR 35721, Oct. 12, 1987

Acts done by the parties to a contract in the course of its performance are admissible in evidence upon the question of meaning as being their own contemporaneous interpretation of its terms.

(3) Some Observations

As a general rule, when the terms of a contract are clear and unambiguous about the intention of the contracting parties, the literal meaning of its stipulations shall control. But if the words appear to contravene the evident intention of the parties, the latter shall prevail over the former. (*Art. 1370*). The real nature of a contract may be determined from the express terms of the agreement, as well as from the contemporaneous and subsequent acts of the parties thereto. (*Art. 1371*). (*Cruz v. CA*, 293 SCRA 239 [1998]; *Sicad v. CA*, 294 SCRA 183 [1998]; and *People's Aircargo & Warehouse Co., Inc. v. CA*, 297 SCRA 170 [1998]).

Upon the other hand, simulation takes place when the parties do not really want the contract they have executed to produce the legal effects expressed by its wordings. (*Villaflor v. CA*, 280 SCRA 297 [1997]; *Tongoy v. CA*, 123 SCRA 99 [1983], and *Rodriguez v. Rodriguez*, 20 SCRA 908 [1967]). Simulation or vices of declaration may be either “absolute” or “relative.” Art. 1345 distinguishes an *absolute* simulation from a relative one while Art. 1346 discusses their effects. Stated in another modality, an absolutely simulated contract of sale is *void ab initio* and transfer no ownership right. The purported buyer, not being the owner, cannot validly mortgage the subject property. Consequently, neither does the buyer at the foreclosure sale acquire any title thereto. (*Edilberto Cruz & Simplicio Cruz v. Bancom Finance Corp. [Union Bank of the Phils.]*, GR 147788, Mar. 19, 2002).

Art. 1372. However general the terms of a contract may be, they shall be understood to comprehend things that are distinct and cases that are different from those upon which the parties intended to agree.

COMMENT:

(1) Effect of the Use of General Terms

Example:

A sold B his house including “all the furniture therein.” Suppose part of the furniture belonged to a relative of A who had asked him (A) for permission to leave them there temporarily, should such furniture be included?

ANS.: No, such furniture should not be included, because although the term “all” is general, still it should “not be understood to comprehend things that are distinct and cases that are different from those upon which the parties intended to agree.” (*Art. 1372, Civil Code*).

In one case, the Supreme Court said: “Considering that the land of the applicant was not the subject of the contract, and that it could not be so for the reason that it did not belong to the vendor, it can in no wise be understood as included in the instrument of sale which appears at folio 66, no matter what may be the terms of the document.” (*Reyes v. Limjap, 15 Phil. 420*)

(2) Cases

**Phil. Trust Co. v. Echaus
52 Phil. 852**

FACTS: A mortgaged his land to C to secure or guarantee B’s debt. B could not pay, so the mortgage was foreclosed, but there was a deficiency. *Issue:* Is A responsible personally for the deficiency?

HELD: No, because it was only his land that was offered as security.

**NAESS Shipping Phils., Inc. v. NLRC
GR 73441, Sept. 4, 1987**

FACTS: *D* had been hired by NAESS to serve aboard a ship under an employment contract which incorporated as part thereof the Special Agreement between the International Workers Federation and NAESS. Said agreement bound NAESS to pay cash benefits for loss of life to workers enrolled therein pursuant to the following provisions:

“Par. 17 — Cash benefits

Compensation for loss of life:

- i) To each dependent child — \$24,844.00.
- ii) To each dependent child under the age of 18 — US \$7,118.”

One night, while on board the vessel of NAESS, *D* fatally stabbed the second cook during a quarrel, then ran to the deck from which he jumped or fell overboard. He was never seen again despite diligent search. NAESS denied liability on the ground that *D* had taken his own life and that suicide was not compensable under the agreement invoked. The POEA rendered judgment for the heirs of *D*, holding *D*’s death compensable under the agreement. The NLRC sustained the POEA. The Supreme Court upheld the decision.

HELD: It makes no difference whether *D* intentionally took his own life, or he killed himself in a moment of temporary aberration triggered by remorse over the killing of the second cook, or he accidentally fell overboard while trying to flee from an imagined pursuit. It is only logical to assume that if it had been intended to subject NAESS’ liability for death benefits to any condition, such as one barring compensation for death by the employee’s own hand, whether intentional or otherwise, the contract would have specifically so provided. No law or rule has been cited which would make illegal for an employer to assume such obligation in favor of his or its employee in their contract of employment. In any case, the Court is not prepared to rule that a contract contravenes public policy and is therefore void which, by not specifically excepting suicide in a clause obligating one of the parties to pay compensation for the death of the

other, may in theory enable the latter's estate, or his heirs, to profit from his self-immolation.

(3) Special Intent Prevails Over a General Intent

Just as a special provision controls a general provision, a special intent prevails over a general intent. (*Hibberd v. Estate of McElroy*, 25 Phil. 164).

Art. 1373. If some stipulation of any contract should admit of several meanings, it shall be understood as bearing that import which is most adequate to render it effectual.

COMMENT:

(1) Stipulation Admitting of Several Meanings

Example:

A wife exchanged "her house" for a diamond ring. Now the wife had a house which was her paraphernal property, and another house, which, however, belonged to the conjugal partnership. The contract entered into by the wife was against the consent of the husband. To which house should "her house" refer?

ANS.: It should refer to her paraphernal house, because this would validate the contract. If the other interpretation would be followed, the exchange would not be valid since the husband had not given consent.

(2) Effect of an Interpretation Upholding the Validity of the Contract

If one interpretation makes a contract valid and illegal, the former interpretation must prevail. (*Luna v. Linatoc*, 74 Phil. 15).

Art. 1374. The various stipulations of a contract shall be interpreted together, attributing to the doubtful ones that sense which may result from all of them taken jointly.

COMMENT:**Stipulations To Be Read Together****Bank of the P.I. v. Ty Camco Sobrino
57 Phil. 801**

FACTS: A mortgaged his property to *B*. In the contract, it was stated that a second mortgage was prohibited, except with the written consent of *B*. The contract further stated that the penalty for such a violation would be that *B* can immediately foreclose the mortgage. Without the consent of *B*, *A* mortgaged the property a second time to *C*. Has *B* the right to consider the second mortgage null and void?

HELD: No, *B* has no right to consider the second mortgage null and void. His only right is to foreclose the first mortgage right now. The whole mortgage contract must be read. Said the Supreme Court:

“The mortgage contract should be read in its entirety. If so read, it is at once seen that while the making of the second mortgage except with the written consent of the mortgagee is prohibited, the contract *continues and states* the penalty for such a violation, namely, it gives the mortgagee (*B*) the right to immediately foreclose the mortgage. It does *not* give the mortgagee the right to treat the second mortgage as null and void.”

**North Negros Sugar Co. v.
Compania Gen. de Tabacos
L-9277, Mar. 29, 1957**

FACTS: A seller sold copra in his bodega to a buyer, to whom he issued a *quedan* (a document authorizing the buyer to get the copra therein, and giving its disposal to the buyer). However, in a letter that accompanied the *quedan*, the seller reserved the right to get the copra from its *other bodegas*. The question at issue was whether or not, in the face of the two conflicting provisions, delivery of the copra in the first bodega had really been made upon the issuance of the *quedan*.

HELD: The various stipulations in a contract must be read together to give effect to all. Thus, to reconcile them, the proper interpretation is this: delivery of the copra was in fact made

upon the delivery of the *quedan*, but said delivery was subject to the right of the seller to *substitute* the same with copra from the other *bodegas*.

Shell Co. v. Firemen's Ins., etc., et al.
L-8169, Jan. 29, 1957

ISSUE: If there should be a controversy as to what the parties really intended to enter into, what should prevail, the *name* given to the contract by the contracting parties or the way the parties performed their respective obligations?

HELD: The latter prevails, for *performance* more clearly indicates their intention than the *name* or *title* given the contract by the parties.

ISSUE: Whenever one contract is incorporated into another, how should both contracts be interpreted?

HELD: Complementary contracts must of course be construed together so as to give effect as much as possible to the provisions of both agreements.

Carlos Bundalio v. Court of Appeals
L-56739, Jun. 22, 1984

If in a sale *a retro* the redemption price is escalated every month, we can presume that the transaction is merely an equitable mortgage.

Art. 1375. Words which may have different significations shall be understood in that which is most in keeping with the nature and object of the contract.

COMMENT:

(1) Words to Be Interpreted in Keeping with the Nature and Object of the Contract

Example:

If authority is given "to exact payment by legal means," does this include authority to file actions in court for the recovery of sums of money?

ANS.: Yes. The clause in question means “the power to exact payment of debts due the concerned by means of the institution of suits for their recovery. If there could be any doubt as to the meaning of this language taken by itself, it would be removed by a consideration of the general scope and purpose of the instrument in which it concurs.” (*German & Co. v. Donaldson, Sim & Co., 1 Phil. 63*).

(2) Meaning of the Article

If a word is susceptible of two or more meanings, what meaning should be used?

ANS.:

- (a) That in keeping with the nature and object of the contract. (*Art. 1375, Civil Code*).
- (b) If this cannot be determined, then the “terms of a writing are presumed to have been used in their primary and general acceptance.” (*Sec. 12, Rule 130, Revised Rules of Court*).

(3) Use of Other Meanings

Despite the fact that the terms are presumed to have been used in their primary and general acceptance, may other meanings or significations be proved?

ANS.: Yes. “Evidence is admissible to show that they have a *local, technical* or otherwise peculiar signification, and were so used and understood in the particular instance, in which case the agreement must be construed accordingly.” (*Sec. 12, Rule 130, Revised Rules of Court*).

Art. 1376. The usage or custom of the place shall be borne in mind in the interpretation of the ambiguities of a contract, and shall fill the omission of stipulations which are ordinarily established.

COMMENT:

(1) Effect of Usage or Custom of the Place

Examples:

- (a) A made a contract with B regarding “*pesetas*.” In the place

where the contract was made, Mexican *pesetas* were more commonly used than Spanish *pesetas*. The Supreme Court held that the term “*pesetas*” should be construed to mean Mexican *pesetas*. (*Yañez de Barnuevo v. Fuster*, 29 Phil. 606).

- (b) If a contract for a lease of services does *not* state how much compensation should be given, the custom of the place where the services were rendered should determine the amount. (*Arroyo v. Azur*, 76 Phil. 493).

(2) Pleading and Proof of Customs and Usages

Should customs and usages be *pleaded* (alleged in the pleading)?

ANS.: Distinguish:

If the customs and usages are *general*, they need not be pleaded. Hence, even without previously being alleged, they may be *proved* in court.

If the customs and the usages are merely local, then they have to be both *alleged* (pleaded) and *proved*.

[NOTE: The Supreme Court has made the following observation: “If a custom be general in character, and therefore presumed to be known by the parties, the rule is that such custom may be proved without being specifically pleaded. This is particularly true when a general custom is offered in evidence to throw light upon a contract, the terms of which are obscure, and which is dependent upon evidence of such general custom to make it plain. If, on the other hand, the customs be local in character, the party who proposes to rely upon it should aver it in his *pleadings*, and a local custom or usage applying to a *special or particular kind of business* (like the custom of “*discounting notes*”) may not be proved to explain even the ambiguous terms of a contract, unless the existence of such custom or usage is pleaded.” (*Andreas v. Bank of the Philippine Islands*, 47 Phil. 795).]

Art. 1377. The interpretation of obscure words or stipulations in a contract shall not favor the party who caused the obscurity.

COMMENT:**(1) Interpretation to Be Against Party Who Caused Obscurity**

Reasons for the law: Since he caused the obscurity, the party who drew up the contract with ambiguous terms should be responsible therefor; so the obscurity must be construed against him. (*Gonzales v. La Provisora Filipina*, 74 Phil. 165). The drafter of the terms of the contract should, therefore, be careful.

(2) Cases**Gov't. of the Phil. v. Derham Bros.
36 Phil. 960**

FACTS: In a contract, it was agreed that a metalled roadway would be built on the *street* where the *real property* was located to "*its entire length*." Now the pronoun "*its*" may refer either to the street or the real property. The government contended that the whole street should be metalled, alleging that the antecedent of "*its*" was the street. Upon the other hand, the contractor said that "*its*" referred throughout the length of the real property (and *not* the whole street) should be metalled. It was the government that drafted the contract. *Issue:* Who is correct, the government or the contractor?

HELD: The contractor is correct. It was the government that cause the ambiguity, so the interpretation of "*its*" should not be in the government's favor and, therefore, it may be concluded that it was *not* intended by the contracting parties that the whole street would be metalled. When different interpretations of a provision are otherwise equally proper, that construction is to be taken which is the most favorable to the party in whose favor the provision was made, and did *not* cause the ambiguity.

**Enriquez v. A.S. Watson and Co.
22 Phil. 623**

FACTS: In a contract of lease, it was provided that the lessee could make "*obras*" (improvements) on the property of the

lessor without the necessity of asking the lessor's permission every time an *improvement* is to be made. The lessee demolished an old wall and erected one of reinforced concrete in its place. The lessor is now blaming the lessee for having demolished the old wall, claiming that the lessee was allowed to make only improvements, not demolitions. *Issue*: Did the demolition of the old one and its substitution by a new one constitute "improvements" or "*obras*"?

HELD: The term "*obras*" or "improvements" is susceptible of different interpretations, and since the ambiguity here was caused by the lessor, the term should not be interpreted in his favor. Hence, it was all right for the lessee to do what he did.

**Pao Chuan Wei v. Romerosa and
General Indemnity Co., Inc.
L-10292, Feb. 28, 1958**

FACTS: A surety bond agreement provided that the surety "will *not* be liable for any claim not discovered and presented to the company within three months from the expiration of the bond, and that the obligee *waives* his right to file any court action against the surety after the termination of the three months aforementioned." *Issue*: If a claim is *presented* within three months, may a court action be still instituted *after* said three months?

HELD: Yes, in view of the following reasons:

- (1) To hold that the prescriptive period should be only three months would be unreasonable and absurd for if a claim is presented to the Company, say on the last day of the period, the Company would still have to approve or deny the claim. If we will hold that said day would also be the last day to file a case in court, clearly the Company is *not* given the chance to approve or to deny; and the obligee is given very little time to file a court claim. This could not have been the intention of the parties.
- (2) If a stipulation in a surety bond can be interpreted as a condition precedent (preparatory to a court suit), or as both a condition precedent and prescription, the ambiguity, if any, must be interpreted against the surety who prepared the form on which the bond was executed.

Lucio Tan v. CA & Sanchez
GR 100942, Aug. 12, 1992

The private respondent correctly observes that it would have been a simple matter for the promisor to state clearly in the promissory note that he would pay the balance of P50,000 only on condition that he would continue to manage and operate the restaurant during that two-year period of the lease. He did not see fit to include this condition in the promissory note he signed.

Assuming an ambiguity in the instrument, Art. 1377 of the Civil Code is applied in that the ambiguity must be resolved against the person who caused it, in this case, the promisor.

Finman Gen. Ass. Corp. v. CA & Surposa
GR 100970, Sept. 2, 1992

FACTS: Deceased Carlie Surposa was insured with petitioner Finman General Assurance Corp. with his parents and brothers — all surnamed Surposa, as beneficiaries. While said insurance policy was in full force and effect, the insured died on Oct. 18, 1988 as a result of a stab wound inflicted by one of three unidentified men without provocation and warning on the part of the former as he and his cousin were waiting for a ride on their way home after attending the celebration of the “Maskara Annual Festival.” Thereafter, private respondent and the other beneficiaries of said insurance policy filed a written notice of the claim with the petitioner insurance company which denied said claim, contending that “murder” and “assault” are not within the scope of the coverage of the insurance policy.

HELD: The insurance company is liable to pay respondent and the other beneficiaries the sum of P15,000 representing the proceeds of the policy with interest. The principle of *expresso unius est exclusio alterius* — the mention of one thing implies the exclusion of another thing — is, therefore, applicable in the instant case since murder and assault, not having been expressly included in the enu-

meration of the circumstances that would negate liability in said insurance policy, cannot be considered by implication to discharge the petitioner insurance company from liability for any injury, disability or loss suffered by the insured. The failure of the petitioner insurance company to include death resulting from murder or assault among the prohibited risks leads inevitably to the conclusion that it did not intend to limit or exempt itself from liability for such death. Thus, Art. 1377 of the Civil Code provides that “[t]he interpretation of obscure words on stipulations in a contract shall not favor the party who caused the obscurity.” Moreover, it is well-settled that contracts of insurance are to be construed liberally in favor of the insured and strictly against the insurer. Ambiguity in the words of an insurance contract should be interpreted in favor of its beneficiary.

(3) Rule in Contracts of Adhesion

Art. 1337 of the Civil Code applies with even greater force in *contracts of adhesion* where the contract is already prepared by a big concern, and the other party merely adheres to it, like insurance or transportation contracts, or bills of lading. (*See 6 R.C.L. 854; See also Qua Chee Gan v. La Union & Rock, Co., Inc. Co., Ltd., 98 Phil. 85*).

Example: Obscure terms in an insurance policy are construed strictly against the insurer, and liberally in favor of the insured. This is to effectuate the dominant purpose of insurance indemnification. This indeed is particularly true in cases where forfeiture is involved. (*Calanoc v. Court of Appeals, 98 Phil. 79*).

National Power Corp. v. CA GR 43706, Nov. 14, 1986

Contracts of insurance are to be construed liberally in favor of the insured and strictly against the insurer. Thus, ambiguity in the words of the insurance contract should be interpreted in favor of its beneficiary.

**Phil. American Gen. Ins. Co. v. Sweet Lines, Inc.
GR 87434, Aug. 5, 1992**

Contracts of adhesion wherein one party imposes a ready-made form of contract on the other are contracts not entirely prohibited. The one who adheres to the contract is in reality free to reject it entirely; if he adheres, he gives his consent.

In the present case, not even an allegation of ignorance of a party excuses non-compliance with the contractual stipulations since the responsibility for ensuring full comprehension of the provisions of a contract of carriage devolves not on the carrier but on the owner, shipper, or consignee, as the case may be. Thus, while it is true that substantial compliance with provisions on filing of claim for loss of, or damage to, cargo may sometimes suffice, the invocation of such an assumption must be viewed *vis-a-vis* the object or purpose which such a provision seeks to attain, and that is to afford the carrier a reasonable opportunity to determine the merits and validity of the claim and to protect itself against unfounded impositions.

Art. 1378. When it is absolutely impossible to settle doubts by the rules established in the preceding articles, and the doubts refer to incidental circumstances of a gratuitous contract, the least transmission of rights and interests shall prevail. If the contract is onerous, the doubt shall be settled in favor of the greatest reciprocity of interests.

If the doubts are cast upon the principal object of the contract in such a way that it cannot be known what may have been the intention or will of the parties, the contract shall be null and void.

COMMENT:

(1) Doubts as to Principal Object or Incidental Circumstances

There may be doubts as to:

- (a) the *principal object*
- (b) or the incidental circumstances (as to whether, for example, a sale or a mortgage is involved)

(2) Doubt as to the Principal Object

Here, the contract is void.

Example: X promised to give Y this (_____). Since the object is unknown, it is clear that there could not have been any meeting of the minds.

(3) Doubts as to the Incidental Circumstances

Apply the following rules:

- (a) If *gratuitous*, apply the rule of “least transmission of rights and interest.”
- (b) If *onerous*, apply the rule of the “greatest reciprocity of interests.”

Example: If A needs a fountain pen and B gives it to him freely (gratuitously), is this a mere donation or a *commodatum*?

ANS.: A mere *commodatum* (loan) for this would transmit lesser rights than a donation.

Another example: It is fairer, in case of doubt, to interpret a mortgage contract as one which is gratuitous rather than one which is onerous. (*Bruiser v. Cabrera*, 81 Phil. 669).

Another example: If a *pacto de retro* contract is not clear as to exactly when redemption has to be made, we should interpret the period as an *indefinite one* (hence, the maximum period is 10 years, rather than 4 years). This is important to effectuate the least transmission of rights. (*Tumaneng v. Abad*, 92 Phil. 18).

Another example: When what has been received for his house by a person needing money is very much less than the value of the house, the courts will be inclined to interpret the transaction more as an equitable mortgage, than as a sale with the right of repurchase, the reason being that in an equitable mortgage, there is in this case greater reciprocity of interests, considering the amount of money received. *Said the Supreme Court:* “Even if there were a doubt as to whether the contract entered into by Vicente

Perez was one of mortgage or one of sale, on the hypothesis that he could dispose of the property, while it is not possible to decide the question by the language of the document, in justice, it must be assumed that the debtor assumed a *lesser* obligation, and that in accord with the creditor he bound himself to execute a mortgage which has a *greater* reciprocity of interests than a contract of sale under *pacto de retro*, in spite of the fact that both the latter and that of mortgage involve a valuable consideration in accordance with the provisions of Art. 1289 of the Civil Code” (*now Art. 1378 of the new Civil Code*). (*Perez v. Cortez*, 15 Phil. 211).

Olino v. Medina
13 Phil. 379

FACTS: A was indebted to B for P175. Because A had no money, C offered to pay, and actually paid P175 to B. Because he was grateful, A consented to the transfer of his land to C. *Issue:* Is this to be considered as a sale, or as a *mere loan with the land as security*?

HELD: This should be considered as a mere loan with the land as security instead of a sale to C, inasmuch as the former involves both the lesser transmission of rights as well as greater reciprocity of interest. *Said the Supreme Court:* “Inasmuch as we are in doubt as to which of the two contracts it was by reason of which Medina (C) furnished the P175, with which Olino (A) redeemed his land from Isidora Rendon (B), and Olino in turn consented to the transfer of the land to Medina, the party who furnished the money, we elect to consider that said contract was that of loan, because such a contract involves a *smaller transmission* of rights and interest, and the debtor does not surrender all rights to his property, but simply confers upon the creditors the right to collect what is owing from the value of the thing given as security, there existing between the parties a greater reciprocity of rights and obligations.”

Art. 1379. The principles of interpretation stated in Rule 123 of the Rules of Court shall likewise be observed in the construction of contracts.

COMMENT:**(1) Supplementary Use of the Principles of Interpretation in the Rules of Court**

Rule 123 as stated in the Article should be construed to refer to Rule 130 of the New Rules on Evidence.

(2) Language in the Place of Execution

“The language of a writing is to be *interpreted* according to the legal meaning it bears in the *place of its execution*, unless the parties intended otherwise.” (*Sec. 8, Rule 130, Revised Rules of Court*).

(3) Meaning of Words Used

“The terms of a writing are presumed to have been used in their primary and general acceptance, but evidence is admissible to show that they have a local, technical, or otherwise peculiar signification, and were so used and understood in the particular instance, in which case, the agreement must be construed accordingly.” (*Sec. 12, Rule 130, Revised Rules of Court*).

(4) Conflict Between Printed and Written (Not Printed) Words

“When an instrument consists partly of written words and partly of a printed form, and the two are inconsistent, the former controls the latter.” (*Sec. 13, Rule 130, Revised Rules of Court*).

**Jarque v. Smith, Bell and Co.
56 Phil. 758**

FACTS: A insured his ship with an insurance company. In the printed policy, the vessel is supposed to be insured against loss. But attached to the policy is a “rider,” a typewritten clause which states that the insurance is only against absolute total loss of the vessel only, and that the insurance company was supposed to pay only the proportionate salvage charges of the

declared value. At the bottom of said rider are found the words “Attaching to and forming part of the National Union Fire Insurance Co., Hull Policy No. 1055.” *Issue*: Which should prevail, the printed words or the typed “rider”?

HELD: “It is a well-settled rule that in case repugnance exists between written and printed portions of a policy, the written portion prevails, and there can be no question that as far as any inconsistency exists, the above-mentioned typed ‘rider’ prevails over the printed clause.”

(5) Use of Experts and Interpreters

“When the characters in which an instrument is written are *difficult to be deciphered*, or the *language is not understood by the Court*, the evidence of persons skilled in deciphering the characters, or who understood the language, is admissible to declare the characters or the meaning of the language.” (*Sec. 14, Rule 130, Revised Rules of Court*).

(6) Interpretation in Favor of a Natural Right

“When an instrument is equally susceptible of two interpretations, one in *favor of a natural right* and the other against it, the former is to be adopted.” (*Sec. 14, Rule 130, Revised Rules of Court*).

[*NOTE*: The right to *redeem* is a natural right. (*Tumaneng v. Abad*, 92 *Phil. 18*).]

(7) Usage or Customs

“An instrument may be construed according to usage, in order to determine its true character.” (*Sec. 17, Rule 130, Revised Rules of Court*).

Chapter 6

RESCISSIBLE CONTRACTS

INTRODUCTORY COMMENT:

(1) The Four Kinds of Defective Contracts

There are four kinds of *defective* contracts (contracts which may be *invalidated*):

- (a) rescissible
- (b) voidable
- (c) unenforceable
- (d) void (which may be *inexistent* or *illegal*)

[NOTE: In general —

- (a) The *rescissible* contract is valid until rescinded; there is a sort of *extrinsic defect* consisting of an economic damage or *lesion*.
- (b) The *voidable* contract is valid till annulled. It can be annulled. It cannot be annulled, however, if there has been a ratification. The defect is more or less intrinsic, as in the case of *vitiated consent*.
- (c) The *unenforceable* contract cannot be sued upon or enforced, unless it is ratified. In a way, it may be considered as a validable transaction, that is, it has *no effect* now, but it may be effective upon ratification.

(NOTE: On the other hand, a voidable contract has effect now, but it may be invalidated; hence, it is deemed valid unless annulled.)

- (d) The *void* contract is one that has *no* effect at all; it cannot be ratified or validated.]

(NOTE: The above-named defective contracts are arranged in the order of *decreasing validity*.)

(2) Comment of the Code Commission

“A great deal of confusion has been created by the faulty terminology used by the old Code as regards defective contracts . . . In order to put an end to the foregoing uncertainty and other ambiguities in the old Code, the Project of the new Civil Code, in a clear-cut and unequivocal way, classifies and defines the various kinds of defective contracts, and states their consequences. There are four kinds of such contracts, namely:

- (1) rescissible;
- (2) voidable;
- (3) unenforceable;
- (4) void or inexistent contracts.”

“The first class, rescissible, remains as they are found in the old Code. All the essential requisites of a contract exist and the contract is valid, but by reason of injury or damage to third persons, such as creditors, the contract may be rescinded.”

“The second kind, voidable contracts, are specifically set forth in Art. 1390 of the new Civil Code.”

“Thus, from various sources in Philippine laws and from decisions of the Supreme Court of the Philippines, a new class of defective contracts is to a certain extent created. The term “unenforceable” is used, as distinguished from ‘voidable.’ The latter are binding, unless annulled by proper action in court, while the former cannot be sued upon or enforced unless they are ratified. As regard the degree of defectiveness, voidable contracts are farther away from absolute nullity than unenforceable contracts. In other words, an unenforceable contract occupies an intermediate ground between voidable and void contracts.”

“Lastly, there are the void or inexistent contracts. They are absolutely null and void.”

“It will thus be seen that the various contracts, in the order (*decreasing*) of their defectiveness, are the following:

- (1) rescissible
- (2) voidable
- (3) unenforceable
- (4) void or inexistent.”

“It is believed that with the explicit provisions of the new Civil Code upon the subject of defective contracts, the old nebulous state of the law has been dispelled. It is neither wise nor just that parties should be left in doubt as to the degree of effectiveness of the contractual relations.”

“The legal profession is entitled to know in a positive and unequivocal manner what contracts are rescissible, voidable, unenforceable, and void. It is hoped that this clarification of the law on this most far-reaching subject will go far toward forestalling many controversies and litigations.” (*Report of the Code Commission, pp. 138-140*).

Art. 1380. Contracts validly agreed upon may be rescinded in the cases established by law.

COMMENT:

(1) ‘Rescission’ Defined

(a) *Scaevola*:

“Rescission is a process designated to render inefficacious a contract validly entered into and normally binding, by reason of *external conditions*, causing an economic prejudice to a party or to his creditors.”

(b) *8 Manresa, pp. 748-749*:

“Rescission is a remedy granted by law to the contracting parties both to contracting parties and to third persons in order to secure reparation of damages caused them by a contract, even if the contract be valid, by means of the restoration of things to their condition prior to the celebration of said contract.”

(c) *Supreme Court*:

It is a relief to protect one of the parties or a third person from all injury and damages which the contract

may cause, to protect some preferential right. (*See Aquino v. Tañedo*, 39 Phil. 517).

(NOTE: Even a voidable contract may be rescinded, for example, by prejudiced creditors. This is particularly true if the injured party does *not* care to ask for annulment.)

(2) Requisites for Rescission

- (a) There must be at the beginning either a valid or a voidable contract (*not* a void one);
- (b) But there is an economic or financial prejudice to someone (a party or a third person);
- (c) Requires *mutual restitution*.

(3) Two Kinds of Rescission

- (a) The rescission mentioned in Art. 1380 of the New Civil Code. This is, properly speaking, “rescission.”
- (b) The rescission mentioned in Art. 1191 of the New Civil Code. Although in this article, the new Code used the term “rescission,” the term, properly speaking, should be “resolution.”

[NOTE:

- 1) Rescission in general (*Art. 1380*)
 - a) is based on *lesion* or fraud upon creditors;
 - b) here, the action is instituted by either of the contracting parties or by third persons;
 - c) here, the courts *cannot* grant a period or term within which to comply;
 - d) here, non-performance by the other party is immaterial.
- 2) Rescission under Art. 1191 (*resolution*)
 - a) is based on non-performance or non-fulfillment of the obligation;

- b) here, the action may be instituted only by the injured party to the contract;
- c) here, in some cases, the courts may grant a term;
- d) here, non-performance by the other party is important.]

Legarda Hermanos v. Suldano
L-26578, Jan. 28, 1974

FACTS: A vendor sold two lots on the installment plan to a buyer who subsequently was able to pay (in installments) an amount, which by itself already exceeded the purchase price of one of the lots. If the buyer does not continue paying, may the vendor successfully ask for the *rescission* (actually, *resolution*) of the sale of the two lots?

HELD: No, otherwise unfairness would result. Here, the vendor was ordered to convey to the buyer *one* of the two lots.

(4) Mutual Dissent

Query: Suppose the parties to a contract mutually agreed to cancel the contract, is this “rescission” properly so-called?

ANS.: No. Of course, in a loose sense “rescission” may be used here. But strictly speaking, this is “mutual backing out,” and not the rescission referred to in Art. 1380 of the new Civil Code. In *mutual withdrawal*, it is the will of the parties that constitutes the basis, whereas in *rescission* (properly called), it is the law that constitutes the basis.

Authority:

“The rescission of the contract between the plaintiff and the defendant was not originated by any of the causes specified in Arts. 1291 and 1292 (now Arts. 1381 and 1382 of the new Civil Code), nor is it a relief for the purposes sought by these articles. It is simply another contract for the dissolution of the previous one, and its effects, in relation to the contract so dissolved, should be determined by the agreement made by the parties, or by the application of other legal provisions, but not by

Article 1295 (now Art. 1385 of the new Civil Code) which is not applicable.” (*Aquino v. Tañedo*, 39 *Phil.* 517, which was about a sale *mutually cancelled* by both parties. A question arose as to whether the buyer had to return the fruits, said obligation being required in an ordinary case for rescission. Here, the Court said that the duty to return the fruits depended on the *agreement* of the parties and not on the legal provisions on rescission, and this is so, even if the parties had erroneously referred to their act as one of rescission.)

(5) Cases

Luneta Motor Co. v. J.B. Richey **(C.A.) 39 O.G. 1101**

FACTS: A bought a car from B, a dealer of cars, on the installment plan. After a while, A brought back the car to the shop of B, saying he could not pay for it. B accepted the car and registered it under its (B's) name. For a long time, B did not communicate with A and asked for the unpaid balance. Later, A received an account for the costs of spare parts and for gasoline. B then brought this action to recover both the unpaid balance and the new account. *Issue:* Has A's obligation been extinguished?

HELD: Yes, A's obligation has already been extinguished. True there had been a contract, but in view of what later happened, said obligation was cancelled.

The contract was perfectly legal and binding. None of the parties should be allowed to disregard it without a legal and valid ground therefor. Both parties may, however, agree to rescind (cancel) it. The question to be determined then, is, did the plaintiff agree to rescind (cancel) the contract? If the vendor had not agreed or consented to the return of the car, why did it register the car in its name? Also, if the vendor had not agreed to rescind (cancel) the contract when the purchaser returned the car, why did it not require immediately, or within a reasonable time, the purchaser to pay the unpaid balance of the note, or to take the car from its shop or premises or to pay storage charges? The contract was rescinded (cancelled).

(**NOTE:** In the above cited case, the use of the term “re-scind” is inexact. What the Court of Appeals should have said

was “cancelled,” in view of the fact that properly speaking, this type of “rescission” is only “rescission” in the loose sense, and not the “rescission” spoken of by the law under the chapter of rescissible contracts.)

Noble v. City of Manila
67 Phil. 1

FACTS: The City of Manila has a contract with Noble stipulating that the City would buy a certain piece of land. It was also agreed that while the purchase price was not yet paid, the City would occupy the land as a tenant and would pay rentals therefor. Later, the City refused to pay the purchase price asserting that it was *excessive* considering the amount it had already paid by way of rentals, and that therefore the contract should be *rescinded* because the contract was far more favorable for Noble than for the City of Manila. *Issue:* Should rescission be granted?

HELD: No, rescission should not be granted. That the contract conferred more favors upon one party than upon another is not a ground for rescission. Besides, even with the rentals already paid, the purchase price cannot be considered excessive because the rentals, together with the price, represented merely a reasonable profit. Of course, even had the profit been excessive, the excessiveness of the price is by itself not a ground for rescission because the only grounds for rescission are those enumerated by the law.

(6) Rescissible Contract Is Not a Void Contract

A rescissible contract is *not* void; it is valid until rescinded. Thus, in the meantime, it can convey title. Moreover, a rescissible contract *cannot* be attacked *collaterally* (incidentally) upon the grounds for rescission in the course of a land registration case. (A *direct* action to rescind is required.) To avoid injustice, however, the court may allow the aggrieved party to *register his reservation of the right to rescind*. The reservation may in fact be noted on the certificates of title. (*Borja v. Addison*, 44 Phil. 895).

(7) Fictitious Contracts Cannot Be Rescinded

A party brought an action to rescind a *fictitious* contract. Is rescission the proper remedy?

ANS.: No, rescission is not the proper remedy because while the contract here is fictitious and, therefore, null and void, rescission presupposes a valid contract. (*Onglengco v. Ozaeta & Hernandez*, 70 Phil. 43).

(8) Extrajudicial Rescission

**Marimperio v. CA
GR 40234, Dec. 14, 1987**

A charter party may be rescinded extrajudicially. A judicial action for the rescission of a contract is not necessary where the contract provides that it may be revoked and cancelled for violation of any of its terms and conditions, “without noting any protest and without interference by any court or any formality whatsoever and without prejudice the Owners may otherwise have on the Charterers under the Charter.”

(9) Right of First Refusal

**Riviera Filipina v. CA
GR 117355, April 5, 2002**

The prevailing doctrine is that a *right of first refusal* means identity of terms and conditions to be offered to the lessee and all other prospective buyers.

And a contract of sale entered into in violation of a right of first refusal of another person, while valid, is rescissible.

Art. 1381. The following contracts are rescissible:

(1) Those which are entered into by the guardians whenever the wards whom they represent suffer lesion by more than one-fourth of the value of the things which are the object thereof;

(2) Those agreed upon in representation of absentees, if the latter suffer the lesion stated in the preceding number;

(3) Those undertaken in fraud of creditors when the latter cannot in any other manner collect the claims due them;

(4) Those which refer to things under litigation if they have been entered into by the defendant without the knowledge and approval of the litigants or of competent judicial authority;

(5) All other contracts specially declared by law to be subject to rescission.

COMMENT:

(1) Enumeration of the Rescissible Contracts

The Article enumerates the various contracts that may be rescinded.

(2) First Case — In Behalf of Wards

- (a) *Lesion* — damage or injury to the party asking for rescission (generally, disparity between the *price* and the value).
- (b) Modern legislation generally does *not* favor rescission on account of *lesion*, because “goods do not have a fixed true value; value is always variable and fluctuating, being a function of supply and demand. The modern codes tend to view lesion of certain proportions (1/4, 1/2, etc.) as *merely raising a presumption of undue influence* that vitiates consent and renders the contract *voidable* whenever the *lesion* is coupled with exploitation by the others. (*Cf. German Civil Code, Art. 138; Mexico, Art. 17*). (*J.B.L. Reyes, Observations on the new Civil Code, Lawyer’s Journal, Jan. 31, 1951, pp. 39-50*). Indeed, mere inadequacy of price, unless shocking to the conscience, is *not* a sufficient ground for setting aside a sale, if there is no showing that, in the event of a resale, a better price can be obtained. (*Cu Bie, et al. v. Court of Appeals; Salvacion S. Tayengco, et al. v. Conchita Sydecohautea, et al., L-17294 and L-17385, Nov. 29, 1965*).
- (c) *Effect of Contracts Entered into in Behalf of Ward*
 - 1) If an *act of ownership*, court approval is required;

otherwise, contract is *unenforceable* (Art. 1403), whether there is *lesion* or *not*.

2) If merely *an act of administration* —

- a) if *with* court approval — *valid*, regardless of *lesion*. (Art. 1386).
- b) if *without* court approval — *rescissible*, if *lesion* is *more than one-fourth*. (Art. 1381, No. 1).

(NOTE: Example of act of ownership: sale or mortgage of minor's land. Example of act of administration: buying of fertilizers for land cultivation, or materials for repair.)

(3) Second Case — In Representation of Absentees

Same comment as in the first case.

[NOTE: Another contract which may be rescinded on the ground of *lesion* is a partition of inheritance, when the *lesion* is 1/4 or more for one heir. (Art. 1098, Civil Code).]

(4) Third Case — “Those Undertaken in Fraud of Creditors, When the Latter Cannot in Any Other Manner Collect Claims Due Them”

- (a) The action to rescind contracts made in fraud of creditors is called “*accion pauliana*.”
- (b) Requisites before *accion pauliana* can be brought:
 - 1) There must be a creditor who became such PRIOR to the contract sought to be rescinded (whether the party asking for rescission is a judgment creditor already or not, is likewise *immaterial*).
 - 2) There must be an alienation made *subsequent* to such credit.
 - 3) The party alienating must be in BAD FAITH (that is, he *knew* that damages would be caused his creditors *whether or not he intended* to cause such damage).
 - 4) There must be no other remedy for the prejudiced creditor — “inability to collect the claims due them.”

(Thus, rescission is merely a subsidiary remedy). (*See Panlilio v. Victoria*, 35 Phil. 706).

[NOTE: An action to rescind may be brought even if the debtor has *not* been judicially declared insolvent (*TS, Jun. 28, 1912*) and even if the creditor has not yet brought an action to collect his credit. (*TS, Dec. 13, 1914*). Since the law makes no distinction, both *secured* and *unsecured* creditors may bring the action; the important thing is that they be prejudiced.]

[NOTE: Generally, the party desiring to rescind must show that the conveyance or alienation was fraudulent. He has the burden of proof, except in the cases when there is a presumption of fraud. (*See Art. 1387, Civil Code; Menzi & Co. v. Bastida*, 63 Phil. 16; and *Ayles v. Reyes*, 18 Phil. 243).]

(c) *Problem:*

To defraud his creditor, A sold his house to X. When however the creditor wanted to collect his credit, somebody lent A enough money. Should the sale of the house still be rescinded?

ANS.: No, it should not be rescinded, because here the creditor can collect the claim due him.

(5) Fourth Case — Things in Litigation

(a) *Example:*

A sues B for recovery of a diamond ring. *Pendente lite*, B sells the ring to C without the approval of A or of the court. The sale to C is rescissible at A's instance in case A wins in the original litigation, unless C is in good faith.

- (b) The property is said to be in litigation here after the defendant has received the service of summons. (*TS, Jan. 25, 1913*).
- (c) To protect himself, the plaintiff must register his claim in the registry of property, pending litigation, if the suit is about real property. This is the *notice of lis pendens*. The purpose is to give notice to the whole world. If personal

property is involved, the property may be levied upon by a *writ of preliminary attachment* (Secs. 1 and 2, Rule 57, Revised Rules of Court); or else, it may be placed in the hands of a receiver. (Rule 59, Revised Rules of Court).

Mortera v. Martinez
14 Phil. 541

FACTS: A piece of land was the subject of a litigation between Martinez and the Municipality of San Pablo. After the case had been decided in favor of Martinez, he sold it to another. *Issue:* Is the sale rescindable on the ground that the property was in litigation?

HELD: No, the sale cannot be rescinded. True, it had been the subject of a litigation, but that litigation had already been decided in favor of Martinez prior to the sale.

(6) Fifth Case — Other Instances

Examples are agreements referred to in Arts. 1098 (partition), 1189 (result of deterioration), 1526 and 1534 (right given to an unpaid seller), and 1539 (sale of real estate) of the Civil Code. See also Art. 1382.

Art. 1382. Payments made in a state of insolvency for obligations to whose fulfillment the debtor could not be compelled at the time they were effected, are also rescissible.

COMMENT:

(1) Premature Payments Made in a State of Insolvency

Two requisites are essential under this Article:

- (a) the debtor-payer must have been *insolvent* (the insolvency need *not* be a judicially declared one);
- (b) the debt was *not* yet due and demandable.

(NOTE: Both conditions are required; otherwise, Art. 1382 cannot apply.)

(NOTE: Art. 1382 does not exactly speak of a contract; it refers to a *payment*; hence, it is not included under Art. 1381.)

(2) Cases

Asia Banking Corporation v. Corcuera 51 Phil. 781

FACTS: The Lichauco Corporation owed Noble Jose P70,000. The Corporation was involvent and although the debt was not yet enforceable, the Corporation gave to Noble Jose a deed of sale to one of its properties (the value of which was much greater than the debt) in payments for the debt. At the same time, the Corporation paid off a certain Corcuera its debt of P24,000 by giving him a piece of land. This latter debt was already due and demandable at the time payment was made.
Issue: Are the two transactions rescindable?

HELD: The first is rescindable because it was made in a state of insolvency for an obligation to whose fulfillment the debtor could not be compelled at the time it was effected. But the second debt is not rescindable because at the time of payment, even if the Corporation was already insolvent, the debt was already due, owing and enforceable.

Pilipinas Bank v. IAC GR 67881, Jun. 30, 1987

FACTS: HB, Inc. sold to JWD a 5,000-square-meter lot for P47,000 payable in installments. On many occasions, HB, Inc. sent letters of demand to pay the balance or unpaid installments and on each occasion, HB, Inc. granted JWD extensions and never called attention to the *proviso* on “automatic rescission.” Finally, HB, Inc. wrote a letter to JWD telling that the contract to sell had been rescinded/cancelled by a notarial act, to which letter was annexed a “demand for rescission of contract.” JWD filed a complaint for specific performance with damages to compel HB, Inc. to execute a deed of sale in his favor and to deliver to him the title of the lot in question.

The trial court held that HB, Inc. cannot rescind the contract to sell because it waived the automatic rescission clause and by sending letters advising JWD of the balances due, thus looking forward to receiving payments on it. Moreover, when JWD made arrangement for the acquisition of additional 870 square meters, HB, Inc. could not have delivered the entire area contracted for, so neither could the buyer (JWD) be liable in default.

HELD: The trial court is correct. There is here a clear waiver of the stipulated right of “automatic rescission,” as evidenced by the many extensions granted the buyer by the seller.

Art. 1383. The action for rescission is subsidiary; it cannot be instituted except when the party suffering damage has no other legal means to obtain reparation for the same.

COMMENT:

(1) Rescission Not a Principal Remedy

Rescission is not a principal remedy; it is only subsidiary and may only be availed of by the injured party if it has no other legal means of seeking redress or reparation for the damages caused. If, therefore, it is found out that the debtor has no other property than that which is the object of the rescindable contract, rescission may merely be applied provided that all the essential requisites for rescission are present. (*Regalado v. Luchsinger & Co.*, 5 *Phil.* 625).

In one case, the Supreme Court held that when a creditor seeks to set aside a contract as fraudulent, he must prove first that he really is a creditor, and secondly, that he cannot collect his debt in any other way. (*Kuenzle & Streiff v. Watson & Co.*, 13 *Phil.* 26).

(2) Cases

**Panlilio v. Victoria
35 *Phil.* 706**

FACTS: When the owner of a drug store began to realize that as a result of a judgment against him, his drug store would

be sold to pay his creditors, the owner connived with a friend by selling to the latter for a small sum the drug store. The creditors were not in any way able to recover from the owner, so they asked for the rescission of said sale of the drug store. *Issue*: Will rescission prosper?

HELD: Yes, the rescission will prosper because this is the only way the creditors can obtain the satisfaction of their credits.

Contreras and Gingo v. China Banking Corp.
76 Phil. 709

FACTS: A and B, a creditor of the former because of certain debts, were declared by the court to be the co-owners of a certain real property. The case was appealed. Pending judgment, A mortgaged the *whole* property to a Bank to get some money. Later, the decision regarding co-ownership was affirmed. *Issue*: May B, who has vainly exhausted other means, now ask for the rescission of the *mortgage*?

HELD: That part of the mortgage referring to the half share of B need not be rescinded since it is already void, considering the fact that A had no right to make the mortgage.

That part of the mortgage referring to the half share of A may be rescinded because it was done in fraud of him, and there is no other way to collect his credit.

Art. 1384. Rescission shall be only to the extent necessary to cover the damages caused.

COMMENT:

(1) Partial Rescission

This is a new provision of the New Civil Code, making possible partial rescission, since after all, the only purpose of rescission is to repair or cover the damages caused. Complete rescission will not therefore be allowed, if it is not justified by the circumstances of the case. Insofar as it is not rescinded, the alienation is valid.

(2) Person Benefited

Only the creditor who has asked for rescission, not the other creditors, benefits from the rescission.

Art. 1385. Rescission creates the obligation to return the things which were the object of the contract, together with their fruits, and the price with its interest; consequently, it can be carried out only when he who demands rescission can return whatever he may be obliged to restore.

Neither shall rescission take place when the things which are the object of the contract are legally in the possession of third persons who did not act in bad faith.

In this case, indemnity for damages may be demanded from the person causing the loss.

COMMENT:**(1) Necessity of Mutual Restitution**

The obligation of *restitution* does not obviously apply to creditors who seek to impugn fraudulent transactions of their debtors. (*TS, March 26, 1923*). The obligation of mutual restitution applies to OTHERS so that the *status quo* may be restored.

(2) Requisites Before the Action for Rescission Can Be Brought

- (a) Generally, the plaintiff must be able to RETURN what has been received by virtue of the rescissible contract. (*Exception: prejudiced creditors.*)
- (b) The thing object of the contract is *not in the legal possession* of third persons in *good faith*.

(NOTE: Example of *legal possession*: registration in the Registry of Property.)

(NOTE: In order that the property be *not* taken away from a third person, said person must *not* only be in legal possession; he must also be in *good faith*. Good faith alone, however, *without* legal possession is not sufficient.)

- (c) There must be no other legal remedy. (*Art. 1383, Civil Code and Kuenzle & Streiff v. Watson and Co., 16 Phil. 26*).
- (d) The action must be brought *within* the proper prescriptive period. (*See Art. 1389, Civil Code*).

(3) Illustrative Questions

- (a) What should be returned in rescinding a contract?

ANS.:

- 1) The *object* of the contract, *with its fruits*, must be returned.
 - 2) The *price*, with its *interest*, must be returned.
- (b) A bought real property from *B*. A brought action to rescind the contract on the ground of non-delivery of the property. Does *B* have to give also the fruits received in the meantime?

ANS.: No, the fruits received need not be given to *A* because the right takes place only when “delivery of the thing sold has been made.” (*Hodges v. Granada, 59 Phil. 429*).

- (c) *A* sold to *B* a piece of land in fraud of his (*A*’s) creditors. *B* took legal possession. If no other means are found to exact the satisfaction of the credits owing the creditors, may the sale to *B* be rescinded?

ANS.: It depends upon whether *B* was in good faith or in bad faith.

- 1) If *B* was in good faith, rescission cannot take place, because the object of the contract is legally in the possession of a third person who did not act in bad faith.
 - 2) If *B* was in bad faith, rescission is proper.
- (d) To defraud his creditors *A* sold to *B* a piece of land. *B* is an innocent purchaser in good faith, who takes legal possession of the land. Since the creditors cannot rescind the contract, what is their remedy?

ANS.: Their remedy in this case would be to demand *indemnity for damages* from the person causing the loss. (*Last sentence, Art. 1385, Civil Code*).

- (e) To really protect himself against rescission, what should an innocent third party, who in good faith purchases real property, do after having acquired the property?

ANS.: He must register the realty purchased in the registration office. (*Cordovero & Aleazar v. Villaruz & Borromeo, 46 Phil. 473*).

- (f) To defraud his creditor, *A* sold his property to *B* (who is in good faith). Later *B* sold the property to *C*, who is in *bad faith*. May the creditor rescind, although the property is now in the possession of *C*?

ANS.: No, for it does not matter whether *C* is in good or bad faith, since he obtained the same from *B* who is in good faith. It is *B's good faith* that is important.

Art. 1386. Rescission referred to in Nos. 1 and 2 of Article 1381 shall not take place with respect to contracts approved by the courts.

COMMENT:

Effect if Contracts Were Judicially Approved

See comments under No. (1) of Art. 1381.

Art. 1387. All contracts by virtue of which the debtor alienates property by gratuitous title are presumed to have been entered into in fraud of creditors, when the donor did not reserve sufficient property to pay all debts contracted before the donation.

Alienations by onerous title are also presumed fraudulent when made by persons against whom some judgment has been rendered in any instance or some writ of attachment has been issued. The decision or attachment need not refer to the property alienated, and need not have been obtained by the party seeking the rescission.

In addition to these presumptions, the design to defraud creditors may be proved in any other manner recognized by the law of evidence.

COMMENT:

(1) Presumptions of Fraud

This Article establishes *presumptions of fraud* in the case of:

- (a) gratuitous alienations;
- (b) onerous alienations.

(2) Gratuitous Alienations

- (a) Presumed fraudulent — when the debtor did *not* reserve sufficient property to pay all debts contracted BEFORE the donation.

- (b) *Example:*

A donated his land to B. Before the time he made the donation, he had several debts, but he did not reserve enough property to pay all these debts. Instead, he made the donation. Is the donation presumed fraudulent.

ANS.: Yes, the donation is presumed in fraud of creditors. But, of course, this presumption may be rebutted by adequate proof.

- (c) *Problem:*

A made a donation to B. Later A contracted several debts. What A has left as assets are much less than his present liabilities. May the donation to B be rescinded?

ANS.: No, because the debts here of A were incurred *after* the donation had been made. As a matter of fact, the presumption of fraud does *not* even arise in this case. However, under the doctrine of “anticipatory fraud,” rescission may still prosper if it can be shown that the donation had been deliberately made beforehand to avoid the payment of debts *still* to be contracted.

(3) Onerous Alienations

- (a) Presumed fraudulent — when made by persons:
 - 1) against whom some judgment has been rendered in *any instance* (thus, even if not yet a final judgment);
 - 2) or against whom some *writ of attachment* has been issued. (*Art. 1387, Civil Code*).
- (b) *Example:*

After a judgment had been rendered against him, A sold his property to B. Is the sale presumed fraudulent?

ANS.: Yes, the sale here is presumed fraudulent because it was made after a judgment had been issued against A. (*See Gaston v. Hernaez, 58 Phil. 823*). Upon the other hand, if the sale had been made BEFORE the judgment, the presumption of fraud cannot apply. This is so even if, unknown to the buyer, the suit had already been brought, but STILL PENDING as long as of course *no attachment* had been issued. (*Adolfo Gaspar v. Leopoldo Dorado, et al., L-17884, Nov. 29, 1965*).

**Isidora L. Cabaliw and Soledad Sadorra v.
Sotero Sadorra, et al.
L-25650, Jun. 11, 1975**

FACTS: After a judgment for support was rendered against a husband and in favor of his wife, the husband sold in a public instrument two parcels of conjugal land (there were only two parcels) to his son-in-law. This was about seven (7) months after the judgment had been rendered. However, the sale was made in 1933 and, therefore, fell under the old Civil Code which authorized in Art. 1413 thereof a husband as administrator of the conjugal partnership to alienate by onerous title conjugal property even without the wife's consent. *Issue:* Is the sale valid?

HELD: The sale should be invalidated because it is presumed to have been made in fraud of the judgment creditor who happens to be the wife, the sale having been

made to avoid payment of the judgment debt for support. The presumption of a fraudulent transaction established by specific provision of law (Art. 1387, New Civil Code; Art. 1297, old Civil Code) cannot be overcome by the mere fact that the deed of sale in question is in the nature of a public instrument. The principle that strong and convincing evidence is necessary to overthrow an existing public document does not apply to third persons (who might be adversely prejudiced) but only to the parties to a contract. Close relationship between the vendor and the vendee is one of the known badges of fraud. The burden of rebutting the presumption of fraud established by law rests on the transferee who claims otherwise. Art. 1413 of the old Civil Code does not apply because here the aggrieved party was prejudiced as a judgment creditor, but even were it to apply, still a prejudiced wife may seek redress in court.

- (c) The *decision* or *attachment* need *not* refer to the property alienated, and need not have been obtained by the party seeking the rescission. (*Art. 1387, Civil Code*).
- (d) *Example:*

A brought an action against *B*, his debtor. *A* won. After judgment, *B* sold his property to *C*. *X*, another creditor of *B*, wants to rescind this sale to *C*. Both *C* and *B* claim that *X* does not have the right to interfere because, after all, it was *A*, not *X*, who had won a judgment against *B*. Are *C* and *B* justified?

ANS.: No, *C* and *B* are not justified. It is true that it was *A*, not *X*, who won the judgment, but this is immaterial since the law says that the decision *need not* have been obtained by the party seeking the rescission. (*2nd sentence, second paragraph, Art. 1387, Civil Code*).

- (e) *Another example:*

In a case, *A*'s house at 11 Leveriza Street was attached by the court. *A* sold his house at 22 San Miguel Street to *B*, after the attachment on the first house had been made. *C*, a creditor of *A*, now says that the sale is presumed fraudulent. *A* counters by saying that there is no such presumption because after all the house which had been attached was not the one sold to *B*. Is *A* justified?

ANS.: No, *A* is not justified. It is true that the house he sold had not been levied upon or attached, but the fact remains that *A* is a person against *whom* some writ of attachment has been issued. The law says that the attachment need not refer to the property alienated. (*2nd sentence, 2nd paragraph, Art. 1387, Civil Code*).

De Jesus v. G. Urrutia and Co.
33 Phil. 171

FACTS: *A* has 2 parcels of land. The first was mortgaged to *B*. During the mortgage, *A* sold the second parcel to *C*. When the mortgage debt fell due, *A* could not pay; hence, the mortgage was foreclosed. Since the land was sold in the foreclosure proceedings for an amount less than the value of the debt, *B* was given the right to get the balance from *A*. But *A* had no more money. *B* now seeks to rescind the sale to *C* of the second parcel of land, alleging the sale was done to defraud him. **Issue:** Is the sale to *C* presumed fraudulent?

HELD: No, the sale to *C* is not presumed fraudulent. It is true that the sale was made after the mortgage of the first parcel of land, but we cannot apply the first presumption in the pertinent article of the Civil Code, because the contract was not gratuitous. The second presumption (about onerous contracts) cannot be also applied because in this case, the sale had been made *prior* to the judgment against *A*, the judgment debtor.

(4) Badges of Fraud

There are some circumstances indicating that a certain alienation has been made in fraud of creditors. These are called **BADGES OF FRAUD**.

Oria v. McMicking
21 Phil. 243

FACTS: To defraud his creditors, a father sold a certain real property to his son for a very small sum. The property, although apparently sold, was nevertheless still occupied by the father.

The transfer was made after suit by the creditors had been instituted against the father. It was also proved that the father had no other property. *Issue*: May the contract be rescinded?

HELD: Yes, the contract may be rescinded as being in fraud of creditors. The Supreme Court made the following observations:

“In determining whether or not a certain conveyance is fraudulent, the question in every case is whether conveyance was a *bona fide* transaction or a trick and contrivance to defeat creditors, or whether it conserves to the debtor a special right. It is not sufficient that it is founded on good consideration, or is made with *bona fide* intent; it must have both elements. If defective in either of these particulars, although good between the parties, it is rescindable as to creditors. The rule is universal both in law and in equity that whatever fraud creates, justice will destroy. The test as to whether or not a conveyance is fraudulent is: Does it prejudice the rights of creditors?

“In the consideration of whether or not certain transfers were fraudulent, courts have laid down certain rules by which the fraudulent character of the transaction may be determined. The following are some of the circumstances attending sales which have been denominated by the courts as badges of fraud:

- 1) The fact that the consideration of the conveyance is fictitious or inadequate;
- 2) A transfer made by a debtor after suit has been begun and while it is pending against him;
- 3) A sale upon *credit* by an insolvent debtor;
- 4) The transfer of all or nearly all of his property by a debtor, especially when he is insolvent or greatly embarrassed financially;
- 5) Evidence of large indebtedness or complete insolvency;
- 6) The fact that the transfer is made between father and son (*when this fact is considered together with preceding circumstances*);

- 7) The failure of the vendee to take exclusive possession of all the property.

“The case at bar presents everyone of the badges of fraud above enumerated. Tested by the inquiry, does the sale prejudice the rights of creditor? The result is clear. The sale in the form it was made leaves the creditors substantially without recourse. The property of the company is gone, the business itself is likely to fail, the property is being dissipated and is depreciating in value. As a result, even if the claims of the creditors should live twelve years, and the creditors themselves wait that long, it is more than likely that nothing would be found to satisfy their claims at the end of the long wait.” (*Regalado v. Luchsinger & Co.*, 5 Phil. 625 and *Manresa’s Commentaries*, Vol. 8, pp. 713-719).

Alpuerto v. Perez Pastor and Roa
38 Phil. 785

FACTS: Pending the termination of a court litigation with him as defendant, a person secretly sold to his son-in-law substantially all his property for less than half the value of said properties. Later, when the case was decided the plaintiff-creditor could not recover anything from the defendant. Hence, he brought an action for the rescission of the sale. The defense stated that the transaction had been made prior to the promulgation of the decision, and that therefore there can be no presumption of “fraud of creditors.” *Issue:* May the sale be rescinded?

HELD: Yes, the sale may be rescinded. Aside from the presumptions given by the Code regarding fraudulent conveyances, the designs to defraud creditors may be proved, as it has been proved in this case, in any other manner recognized by the law of evidence. Said the Supreme Court:

“The purchaser did not satisfactorily prove that he was a purchaser in good faith. The secrecy of the purported sale and the relation of kinship existing between the parties are circumstances indicative of collusion.”

[*NOTE:* Relationship alone does not by itself constitute a badge of fraud. (*Smo. Nombre de Jesus v. Sanchez*, {C.A.} 40 O.G. 1685).]

[NOTE: If there is great disparity between the price and the real value of the property, this is an indication of badges of fraud. (*Asia Bank v. Noble Jose*, 51 Phil. 736).]

(5) Rule in Case of Registered Lands

Abaya v. Enriquez, et al. L-8988, May 17, 1957

(Illustrating the principle that the presumption of fraud established in Art. 1387 does *not* apply to registered lands under the Torrens System IF the *judgment or attachment* made is not also registered.)

FACTS: Enriquez owed Abaya a sum of money evidenced by a promissory note. Abaya obtained a judgment, and *part payment* was made by Enriquez, leaving the judgment partially unsatisfied. Subsequently, Enriquez sold two registered parcels of land to the spouses Artemio and Nera Jongco, complete strangers to them. The judgment in favor of Abaya and the writ of execution issued were never annotated at the back of the Transfer Certificate of Title to the land. Abaya assailed the validity of the alienation on the ground that same has been made in fraud of his rights, the transaction having been effected after a judgment and an attachment had been issued. Thus, he sued for the rescission of the sale.

HELD: The rescission will not prosper, for the presumption established in Art. 1387 does not apply in this case for two reasons: *Firstly*, the spouses Jongco had no complicity at all in the fraud imputed to Enriquez; *secondly*, the encumbrance of the judgment and the attachment, not having been registered and annotated on the certificate, cannot prejudice an innocent purchaser for value of registered land. The Civil Code must yield to the Mortgage and to the Registration Laws, which are special laws.

(6) Valid Before Rescission

Borja v. Addison 44 Phil. 895

FACTS: To defraud his creditors, A sold real property to B. *Issue:* Before the sale is rescinded, is it valid?

HELD: Yes, it is valid. Sales of real property for the purpose of defeating or frustrating judgment creditors are not valid. Until they are rescinded, they are legally effective and can convey title.

(7) Necessity of a Direct Action for Rescission

To defraud his creditors, A sold real property to B. B now seeks to register the land. X, a creditor, seeks to prevent the registration on the ground that the transaction is rescindable. Despite X's objection, may the land be registered in B's name?

ANS.: Yes. X should have brought first the action for rescission. Before a sale is rescinded, it is valid, and its validity cannot be attacked *collaterally* (in a proceeding different from an action to rescind) in a proceeding like land registration. (*Borja v. Addison*, 44 Phil. 895).

(8) Presumption of Validity

A gratuitous conveyance or donation validly executed is, on its face (*prima facie*), presumed valid and good as between the parties. It cannot be declared fraudulent and, therefore, subject to rescission unless it can be shown that at the time of the execution of the conveyance, there was a creditor or creditors whom said transaction may affect adversely. (*Solis v. Chua Pua Hnos., et al.*, 50 Phil. 636).

(9) Fraud Alone Not Sufficient for Rescission

QUES.: Just because a contract is made to defraud creditors, does this necessarily mean that it can be rescinded?

ANS.: No, for after all the transferee may have been in good faith and is now in legal possession of the property. (See Art. 1385, 2nd paragraph, Civil Code).

Art. 1388. Whoever acquires in bad faith the things alienated in fraud of creditors, shall indemnify the latter for damages suffered by them on account of the alienation, whenever, due to any cause, it should be impossible for him to return them.

If there are two or more alienations, the first acquirer shall be liable first, and so on successively.

COMMENT:

(1) Effect of Bad Faith

- (a) The acquirer must return or *indemnify*.
- (b) “Due to any cause” includes a fortuitous event.
- (c) *Example:*

To defraud his creditors, *X* sold his house to *Y*, who knew of *X*’s purpose. If the sale is rescinded, *Y* must indemnify, even if the house be destroyed by a fortuitous event, but only if *X* himself cannot pay. (Remember that rescission is merely a secondary remedy available only when *X* cannot pay.)

(2) Subsequent Transfers

- (a) If the first transferee is in *good faith*, the good or bad faith of the next transferee is *not* important.
- (b) If the first transferee is in *bad faith*, the next transferee is liable only if he is also in *bad faith*.
- (c) *Example:*

A, in fraud of creditors, sold his house to *B*, who is in bad faith. *B* in turn alienated it in favor of *C*, who later sold it to *D*. Both *C* and *D* were also in bad faith. The contract is rescinded but the house is destroyed. Who, if any, are liable for damages?

ANS.: *B* is liable first. If he cannot pay, then *C* will be liable. If *C* cannot pay, *D* will be liable. The law says that “if there are two or more alienations, the first acquirer shall be liable first, and so on successively.” (*2nd paragraph, Art. 1388, Civil Code*).

(3) Concept of “Bad Faith”

“Bad Faith” has been defined as a state of mind affirmatively operating with furtive design or with some motive or

self-interest or ill-will or for an ulterior purpose, and implies a conscious and intentional design to do a wrongful act for a dishonest purpose or moral obliquity. (*See Republic v. Desierto*, 481 SCRA 153 [2006]; and *Gatmaitan v. Gonzales*, 492 SCRA 591 [2006]).

Nonchalance in performing an urgent obligation indicates gross negligence amounting to bad faith. (*Radio Communications of the Phils., Inc. v. Verchez*, 481 SCRA 384 [2006]). Nonetheless, in ascertaining the intention of the persons accused of acting in bad faith, courts must carefully examine the evidence as to the conduct and outward acts from which the inward motive may be determined. (*Francisco v. Co*, 481 SCRA 241 [2006]).

MIAA v. Rodriguez
483 SCRA 619 (2006)

Regardless of whether or not a person acted in bad faith in buying property which he knew very well to have been occupied for sometime by the MIAA, all that such person will be entitled to is the value of the property at the time of taking, with legal interest thereon from that point until payment of the compensation.

In the instant controversy, there is nothing wrongful or dishonest in expecting to profit from one's investment.

Citibank, N.A. v. Cabamongan
488 SCRA 517 (2006)

The act of the bank's employees in allowing the pretermination of a deposition is account despite the noted discrepancies in the depositor's signature and photograph, the absence of the original certificate of time and deposit and the lack of notarized waiver dormant, constitutes gross negligence amounting to bad faith under Art. 2220 of the new Civil Code.

Art. 1389. The action to claim rescission must be commenced within four years.

For persons under guardianship and for absentees, the period of four years shall not begin until the termination of

the former's incapacity, or until the domicile of the latter is known.

COMMENT:

(1) Prescriptive Period for Rescission

- (a) *General rule* — 4 years from the date the contract was entered into.
- (b) *Exceptions*:
 - 1) persons *under guardianship* — 4 years from termination of incapacity
 - 2) *absentees* — 4 years from the time the domicile is known

(2) Examples

- (a) Five years after a rescindable contract was made, action was brought for its rescission. The person who asked for the rescission was neither a ward nor an absentee at the time of the transaction of the rescindable contract. Will rescission still be allowed?

ANS.: No, the rescission will no longer be allowed because the action has already prescribed. "The action to claim rescission *must be commenced* within four years." (*1st paragraph, Art. 1389, Civil Code*).

- (b) At the time he was 12 years old, A was under a guardian who sold, in behalf of the ward but without judicial authority, the harvest of the ward's farm, and in so doing the ward suffered a lesion of more than one-fourth of the property. How many years will be given the ward to rescind the contract?

ANS.: The ward will be given 4 years after reaching the age of majority (the time the guardianship ceases); hence, before reaching 22 years of age, the former ward should already have sued for the rescission of the contract. (*2nd paragraph, Art. 1389, Civil Code*).

(3) Who Can Bring the Action?

- (a) The injured party (or the defrauded creditor).
- (b) His heir or successor-in-interest.
- (c) Creditors of (a) and (b) by virtue of Art. 1177 of the Civil Code (*accion subrogatoria*).

(4) Who May Be Defendants?

(See Art. 1388 of the Civil Code and comments thereon.)

Chapter 7

VOIDABLE CONTRACTS

Art. 1390. The following contracts are voidable or annulable, even though there may have been no damage to the contracting parties:

(1) Those where one of the parties is incapable of giving consent to a contract;

(2) Those where the consent is vitiated by mistake, violence, intimidation, undue influence or fraud.

These contracts are binding, unless they are annulled by a proper action in court. They are susceptible of ratification.

COMMENT:

(1) Distinctions Between a Rescissible and a Voidable Contract

(8 Manresa 748; Onglengco v. Ozaeta, 70 Phil. 43).

<i>RESCISSION</i>	<i>ANNULMENT</i>
(a) The basis here is <i>lesion</i> (damage).	(a) The basis here is <i>vitiated consent</i> or <i>incapacity to consent</i> .
(b) The defect here is external or intrinsic.	(b) The defect here is intrinsic (in the meeting of the minds).
(c) The action is <i>subsidiary</i> .	(c) The action is <i>principal</i> .
(d) This is a remedy.	(d) This is a sanction.
(e) <i>Private</i> interest governs.	(e) <i>Public</i> interest governs.
(f) Equity predominates.	(f) Law predominates.

(g) Plaintiff may be a <i>party</i> or a <i>third person</i> .	(g) Plaintiff must be a party to the contract (whether bound principally or subsidiarily).
(h) There must be damage to the plaintiff.	(h) Damage to the plaintiff is immaterial.
(i) If plaintiff is indemnified, rescission cannot prosper.	(i) Indemnity here is <i>no</i> bar to the prosecution of the action.
(j) Compatible with the perfect validity of the contract.	(j) Here, a defect is presupposed.
(k) To prevent rescission, ratification is <i>not</i> required.	(k) To prevent annulment, ratification is required.

(2) Voidable Contract Not Void Ab Initio

A contract where consent is vitiated, such as by violence or intimidation, is *not* void *ab initio* but only voidable, and is binding upon the parties unless annulled by proper action in court; so, in a case where the plaintiff corporation’s stockholders sold their entire stocks to a Japanese corporation in 1943, it cannot recover its former properties which were, after liberation, turned over to the Republic as enemy-owned properties. A mere allegation that the sale to the Japanese firm had been perfected thru intimidation will *not ipso facto* revert to stockholders of the plaintiff the ownership of the stocks without any judicial declaration. Indeed, one who desires to recover lands as the owner from another upon the theory that the deeds held by the other are null and void, must first ask that such alleged fraudulent deeds be set aside. (*Pio Grande Rubber Estate, Inc. v. Board of Liquidators, et al.*, L-11321, Nov. 28, 1958).

(3) Grounds for Annulment (Declaration of Nullity)

- (a) incapacity to consent
- (b) vitiated consent

NOTE: Repentance at having entered into the transaction is NOT a ground for annulment. (*Gomez v. Rono*, [C.A.] 45 O.G. 3929, citing *Vales v. Villa*, 35 Phil. 769).

The reason given is that it is not the function of the law to protect or relieve a man from the consequences of a bad bargain.

Mercedes Canullas v. Hon. Willelmo Fortun
L-57499, June 22, 1984

If a house is built with conjugal funds on the husband's lot, the house and the lot will be both considered conjugal, with the husband becoming the creditor of the conjugal partnership to the extent of the value of the lot. Should the husband sell the house and lot without his wife's consent, the sale would be *voidable*.

(4) The Action to Bring

- (a) For POSITIVE REDRESS, an action (complaint, or counterclaim) must be filed; otherwise, the contract remains binding. (*Art. 1390, Civil Code; Llacer v. Muñoz, 12 Phil. 328; and Rone v. Claro, 91 Phil. 250*).
- (b) For use as a DEFENSE — ordinarily, no affirmative action is needed.

Lopez v. Jimmy Ong
L-9021, May 31, 1957

FACTS: Ong leased a theater beginning September 1951. In the lease contract with the owner, Ong agreed to allow a certain employee named Lopez to continue with his job till December 31, 1951. Lopez subsequently made Ong sign a document which *continued* Lopez's employment till 1956, but which Lopez had fraudulently told Ong (who did *not* understand English, the language of the document) merely continued Lopez's job till *Dec. 31, 1951*. On Jan. 31, 1952, Ong dismissed Lopez. Lopez filed an action for damages on the ground that he had been dismissed unjustifiably before 1956.

HELD: The contract is voidable because of fraud; therefore, Ong can validly dismiss Lopez. The fact that dismissal was made on Jan. 31, 1952 instead of *Dec. 31, 1951* cannot by itself be considered a ratification since the period is *too short* to warrant a validation of the contract.

Art. 1391. The action for annulment shall be brought within four years.

This period shall begin:

In cases of intimidation, violence or undue influence, from the time the defect of the consent ceases.

In case of mistake or fraud, from the time of the discovery of the same.

And when the action refers to contracts entered into by minors or other incapacitated persons, from the time the guardianship ceases.

COMMENT:

(1) Historical Notes on Prescriptive Period for Annulment

This is a substantial restatement of Art. 1301 of the old Civil Code, with the following changes:

- (a) “Undue influence” has been added in the third paragraph. In the old Civil Code, this was not found.
- (b) In the fourth paragraph, the old Civil Code provision reads as follows: “In those of error or deceit or falsity of consideration, from the date of the consummation of contract.”
- (c) The provision in the old article which reads “when the purpose of the action is to invalidate the unauthorized contracts of a married woman, from the date of the dissolution of the marriage” has been eliminated because, as a rule, married women are no longer classed together with persons not capacitated to give consent.

(2) Effect of Prescription

If the action has prescribed, the contract can no longer be set aside. (*Villanueva v. Villanueva*, 91 Phil. 43).

(3) Illustrative Problems

- (a) A was intimidated into signing a contract on June 1, 1999. The intimidation continued until Sept. 1, 2001. From what

time should we compute the four-year period for annulment?

ANS.: From Sept. 1, 2001, the time the intimidation ceased.

- (b) On June 1, 2005, *A* entered into a contract with *B*. On Jan. 4, 2006, *A* discovered that fraud had been present at the time he entered into the contract. Such a fraud vitiated his consent. Within what time must *A* bring the action for annulment?

ANS.: Within 4 years from Jan. 4, 2006 *A* must bring action for annulment; otherwise, his right to sue for said annulment will have prescribed. Jan. 4, 2006 should be the starting point because it was on this date that the fraud was discovered.

- (c) In the case of contracts entered into by minors or incapacitated persons, from what time will the period within which to bring the annulment begin?

ANS.: From the time the guardianship ceases. (*See Ullman v. Hernaez, 30 Phil. 69*).

**Carantes v. Court of Appeals
L-33360, Apr. 25, 1977**

FACTS: Certain co-heirs assigned, in 1939 in favor of a co-heir, a parcel of land in Loakan, Baguio. The document was registered in 1940. The assignors sued in 1958 for the annulment of the assignment, claiming that they thought they were signing a mere authority to sell, not the sale itself. *Issue:* Has the action prescribed?

HELD: Yes. Considered as a fraudulent contract, the period allowed for bringing the action is only 4 years, counted from registration in 1940 of the deed of assignment; considered as a constructive trust, the period is 10 years.

**Metropolitan Waterworks and
Sewerage System v. CA
GR 12600 and 128520, Oct. 7, 1998**

FACTS: In 1965, the MWSS leased a piece of land to Capitol Hills Golf Club, Inc. (CHGCI) with a right of

first refusal in case the property is sold. After President Ferdinand E. Marcos issued Letter of Instruction 440 in 1976, MWSS offered to sell to Capitol Hills the property at P40.00 per square meter.

The Board of Trustees of MWSS approved the sale in favor of Silhouette Trading Corp. (STC), as assignee of CHGCI. The contract was signed in 1983. In 1984, STC sold part of the property to Ayala Land, Inc. (ALI) which paid P110.00 per sq. m. In 1993, MWSS filed an action against ALI, STC, and CHGCI to recover the property — alleging that the MWSS Board of Trustees was unduly influenced by Marcos in approving the sale. On motion of the defendants, the complaint was dismissed on the ground, *inter alia*, that the action had prescribed.

HELD: Under Art. 1391 of the Civil Code, contracts where consent is given thru mistake, violence, intimidation, undue influence or fraud — are valid until they are annulled. As the contract in question is merely voidable, the period within which to annul the same is 4 years, counted, in cases of intimidation, violence, or undue influence, from the time the defect of the contract ceases, and in case of mistake or fraud, from the time of discovery.

In the case at bench, the prescriptive period to annul the sale would have begun on Feb. 26, 1986 when Marcos was deposed. Prescription would have set in by Feb. 26, 1990 or more than 3 years before MWSS filed its complaint. However, if MWSS' consent was vitiated by fraud, then the prescriptive period commenced upon discovery. Discovery commenced from the date of execution of the sale documents as petitioner was party thereto. At the least, discovery is deemed to have taken place on the date of registration of the deeds with the Register of Deeds as registration is constructive notice to the world. Given these two principles on discovery, the prescriptive period commenced in 1983 as MWSS actually knew of the sale, or in 1984 when the agreements were registered and titles thereafter were issued to STC. At the latest, the action would have prescribed in 1988, or about 5 years before the complaint was instituted.

Art. 1392. Ratification extinguishes the action to annul a voidable contract.

COMMENT:

(1) Confirmation, Ratification, Acknowledgment Distinguished

Technically and properly, the following terms must be used:

- (a) *Confirmation* — to cure a defect in a *voidable contract*. (*Art. 1396, Civil Code*).
- (b) *Ratification* — to cure the defect of lack of authority in an *authorized contract* (entered into by another). (*Arts. 1317 and 1405, Civil Code*).
- (c) *Acknowledgment* — to remedy a deficiency of proof (*Art. 1405, Civil Code*) (thus, an oral loan may be put in writing, or when a private instrument is made a public instrument). (*Luna v. Linatoc, 74 Phil. 15*).

(2) Term in the Civil Code

Under the New Civil Code, all the three terms are now uniformly called RATIFICATION.

[NOTE: A sale made to a buyer by a seller who would be entitled to the land only when a certain suspensive condition is fulfilled, but which sale was made *prior* to the fulfillment of said condition is *confirmed* when, after the fulfillment of the condition, the seller executes an *affidavit* acknowledging the transfer of the property to the buyer. (*Dalay v. Aquiatin, 47 Phil. 951*).]

(3) Effects of Ratification

- (a) The action to annul is extinguished (*Art. 1392, Civil Code*); thus, the contract becomes a completely valid one. (*Gutierrez Hnos. v. Orense, 28 Phil. 751*).
- (b) The contract is cleansed of its defect from the *beginning*. (*Art. 1396, Civil Code*).

(4) Requisites of Ratification (Properly, Confirmation of a Voidable Contract)

- (a) The contract must be a *voidable one*.
- (b) The person ratifying must know the reason for the contract being voidable (that is, the cause must be known).
- (c) The cause must *not exist* or continue to exist anymore at the time of ratification.
- (d) The ratification must have been made expressly or by an act implying a waiver of the action to annul.
- (e) The person ratifying must be the injured party.

Art. 1393. Ratification may be effected expressly or tacitly. It is understood that there is a tacit ratification if, with knowledge of the reason which renders the contract voidable and such reason having ceased, the person who has a right to invoke it should execute an act which necessarily implies an intention to waive his right.

COMMENT:**(1) Kinds of Ratification**

- (a) Express (oral or written)
- (b) Tacit (implied — as from conduct implying a WAIVER).

(2) Examples of Tacit Ratification

- (a) A minor bought land, but sold the same, after reaching 21 years of age, to a 3rd person. (*Rosales v. Reyes*, 25 Phil. 495 and *Atacador v. Silayan*, 67 Phil. 674).
- (b) A minor sold land, and upon reaching majority age, collected the unpaid balance of the selling price (*Tacalinar v. Corro*, 34 Phil. 898), or spend the greater part of the proceeds of the sale. (*Uy Soo Lim v. Tan Unchuan*, 38 Phil. 552).
- (c) Use of the proceeds by a person who had been previously intimidated into selling his property. (*Madlambayan v. Aquino*, [C.A.] 51 O.G. 1925, Apr. 1955).

- (d) Voluntary performance by the injured party of his own obligation, after the cause of the nullity was known to him. (*Tan Ah Chan v. Gonzales*, 52 Phil. 180).

(3) Lapse of Time

In the case of *Tipton v. Velasco* (6 Phil. 67), the Supreme Court said that mere lapse of time does not legalize a voidable contract; but in *Fabie v. Yulo* (24 Phil. 240), it was held that remaining silent for a certain period of time ratifies such a contract.

Art. 1394. Ratification may be effected by the guardian of the incapacitated person.

COMMENT:

(1) Ratification by Guardian

- (a) This Article refers to the ratification of a contract entered into by the incapacitated person.
- (b) Since the person entitled to ratify is still incapacitated, his guardian acts in his behalf. (*See Escoto v. Arcilla*, 89 Phil. 199).

(2) Ratification by the Injured Party Himself

Ratification can be made by the injured party himself, provided he is capacitated, or has become capacitated.

(3) Distinguished from Action to Rescind

Art. 1394 does not refer to a rescissible contract entered into by the guardian in behalf of his ward.

Art. 1395. Ratification does not require the conformity of the contracting party who has no right to bring the action for annulment.

COMMENT:

Conformity of Guilty Party Not Needed

Reason: The guilty party's consent is *not* needed; otherwise,

he may find a way of getting out of the contract by the simple expedient of refusing to ratify.

Art. 1396. Ratification cleanses the contract from all its defects from the moment it was constituted.

COMMENT:

(1) Retroactive Effect of Ratification

- (a) Note the retroactive effect; thus, once ratification has taken place, annulment based on the original defects cannot prosper. (*Tan Ah Chan v. Gonzales*, 52 Phil. 180).
- (b) Although there is a retroactive effect, the rights of innocent third persons must not be prejudiced.

(2) Example

A minor sold his land to X. When he became 22 years old, he became indebted to Y. To avoid paying Y, the former minor decided to ratify the sale of the land. He then had no other property. May Y still rescind the sale although at the time it was made he was not yet a creditor?

ANS.: Yes. Although ratification has a retroactive effect, still his rights as an innocent third person must *not* be prejudiced.

Art. 1397. The action for the annulment of contracts may be instituted by all who are thereby obliged principally or subsidiarily. However, persons who are capable cannot allege the incapacity of those with whom they contracted; nor can those who exerted intimidation, violence, or undue influence, or employed fraud, or caused mistake base their action upon these flaws of the contract.

COMMENT:

(1) Persons Who May Ask for Annulment

The victim (principal or subsidiary party) may ask for annulment, *not* the guilty person or his successor. *Reason:* He who comes to equity must come with clean hands. (*Bastida v. Dy Buncio and Co.*, 93 Phil. 195).

Mendoza v. De Guzman
(C.A.) 39 O.G. May 27, 1941, p. 1505

FACTS: A minor contracted with X. X's heir, Y, sues for annulment on the ground that the other party was a minor.

HELD: Annulment cannot prosper, for just as X has no right to sue, being the capacitated party, so also Y, who merely derives any right he has from his predecessor-in-interest, X.

Development Bank v. Court of Appeals
L-28774, Feb. 28, 1980

The general rule is that the action for the annulment of contracts can only be maintained by those who are bound either principally or subsidiarily by virtue thereof. (*Art. 1397, Civil Code*). There is, however, an exception to the rule: A person who is not obliged principally or subsidiarily in a contract may exercise an action for nullity of the contract if he is *prejudiced* in his rights with respect to one of the contracting parties, and can show the detriment which could positively result to him from the contract in which he had no intervention. (*Teves v. People's HHC, L-21498, Jun. 27, 1968; De Santos v. City of Manila, L-21677, Jun. 29, 1972 and Bañez v. Court of Appeals, L-30351, Sept. 11, 1974*).

Development Bank of the Philippines v.
Court of Appeals
L-28774, Feb. 28, 1980

A person not obliged *principally* or subsidiarily in a contract *may nevertheless ask* for its annulment if he is prejudiced in his rights regarding one of the contracting parties. (*See also Bañez v. Court of Appeals, L-30351, Sept. 11, 1974*).

CFI of Rizal and Elena Ong Escutin v.
Court of Appeals and Felix Ong
Jul. 25, 1981

A private sale authorized by a probate court (and without objection on the part of the heirs or creditors) cannot be assailed by a person who is not an "interested party" (such as an heir or creditor). One who merely offered a higher price (without actu-

ally buying the property) is not “an interested party.” It would have been different had there been a public auction.

**Earth Minerals Exploration v. Deputy
Executive Sec. Catalino Macaraig, Jr.
GR 78569, Feb. 11, 1991**

FACTS: Zambales Chromite is the exclusive owner of ten patentable chromite mining claims. Zambales Chromite as claim owner, on one hand, and Philzea Mining as operator, on the other, entered into a “contract of development, exploitation and productive operation on the mining claims.” During the lifetime of such contract, Earth Minerals submitted a letter of intent to Zambales Chromite, whereby the former proposed, and the latter agreed, to operate the same mining area subject of the earlier agreement between Zambales Chromite and Philzea Mining. Consequently, the same mining property of Zambales became the subject of different agreement with two separate and distinct operators. Earth Minerals filed with the Bureau of Mines a petition for cancellation of the contract between Zambales Chromite and Philzea Mining, pursuant to Section 7, Presidential Decree 1281. Earth Minerals alleged that Philzea committed grave violations of the latter’s contract with Zambales Chromite, among which are: failure to produce the agreed volume of chromite ores; failure to pay *ad valorem* taxes; failure to put up assay buildings and offices, all resulting in the non-productivity and non-development of the mining area. Philzea moved to dismiss on the grounds that Earth Minerals is not the proper party in interest and that the petition lacks a cause of action. The Bureau of Mines denied the motion holding that “there appears some color of right” on Earth Minerals to initiate the petition for cancellation. Philzea elevated the case to the Ministry of Natural Resources which dismissed the appeal for the reason that the Bureau’s order was an interlocutory order that could not be the proper subject of an appeal. Philzea appealed to the office of the President. During the pendency thereof, Earth Minerals filed with the MNR a motion for execution of the Ministry of Natural Resources’ (MNR) order dismissing Philzea’s appeal. The MNR directed the Bureau of Mines to conduct the necessary investigation to hasten the development of the mining claims. In compliance therewith, the Bureau of Mines ordered Philzea to file its answer to Earth Minerals’ petition for rescission. Philzea did not

submit its answer. So, the Bureau of Mines resolved the petition based on the documents submitted by Earth Minerals. Finding that Philzea violated the terms and conditions of the mining contract between Philzea and Zambales, the Bureau of Mines cancelled said mining contracts. The Office of the President set aside the decision of the Minister of Natural Resources and the Bureau of Mines. As to whether Earth Minerals is the proper party to seek cancellation of the operating agreement between Philzea Mining and Zambales Chromite, the Executive Secretary argues that Earth Minerals is not the proper party to file the petition for cancellation of the contract between Zambales Chromite and Philzea Mineral, citing Article 1311 of the Civil Code which provides that a contract takes effect only between the parties, their assigns and heirs.

HELD: Setting aside the decision of the Executive Secretary and reinstating the orders of the Bureau of Mines and the Minister of Natural Resources, the Supreme Court held that the contention is untenable. Earth Minerals seeks the cancellation of the contract between Zambales Chromite and Philzea Mining, not as a party to the contract but because its rights are prejudiced by said contract. The prejudice and detriment to the rights and interest of Earth Minerals stem from the continued existence of the contract between Zambales Chromite and Philzea. Unless and until the contract between Zambales Chromite and Philzea Mining is cancelled, Earth Minerals' contract with the former involving the same mining area cannot be in effect and it cannot perform its own obligations and derive benefits under the contract. Moreover, the decision of the Director of Mines as affirmed by the Minister of Natural Resources was supported by substantial evidence. The violations committed by Philzea Mining were not only violations of its operating agreement with Zambales Chromite but of mining laws as well.

(2) Creditors of the Victim

The creditors of the victim cannot ask for annulment for they are *not* bound by the contract.

Illustrative Problem:

A was forced by B to sign a contract. C, a creditor of A, wants to *annul* the contract. Is C allowed to do so?

ANS.: No, *C* is not allowed to do so. If the contract prejudices him, and *A* has no other property, then *C* may ask for the *rescission* of the contract, not its annulment. *C* cannot ask for annulment because he is *not* obliged by the terms of said contract, either principally or subsidiarily.

Problem: A minor forces *X* to sign a contract. May the minor later on ask for annulment?

ANS.: No, because he himself is at fault.

(3) Intimidation or Fraud by a Minor

If a minor misrepresents his age and the other party is misled as to his age, may the minor later on sue for annulment?

- (a) No, because of estoppel. (*Mercado v. Espiritu*, 37 Phil. 37).
- (b) Later on, the Supreme Court had a different view and answered YES, because according to it, a minor can never be guilty of estoppel since he is not liable for his conduct or act. (*Young v. Tecson*, 39 O.G. 953).
- (c) Still later on, the Court again changed its mind and answered NO, reiterating the *Mercado* case. (*Sia Suan & Chao v. Alcantara*, GR L-1720, March 4, 1950, 47 O.G. 4561, where the minor, nearly 20 years old, appeared to be very clever.)

Art. 1398. An obligation having been annulled, the contracting parties shall restore to each other the things which have been the subject matter of the contract, with their fruits, and the price with its interest, except in cases provided by law.

In obligations to render service, the value thereof shall be the basis for damages.

COMMENT:

(1) Effects of Annulment

- (a) If the contract has not yet been complied with, the parties are excused from their obligations.

- (b) If the contract has already been performed, there must be **MUTUAL RESTITUTION** (in general) of:
 - 1) the thing, with *fruits*;
 - 2) the *price*, with *interest*.

(2) Examples

- (a) **Mun. of Cavite v. Rojas**
30 Phil. 602

FACTS: A leased a parcel of land from the Municipality of Cavite. Later the lease was annulled. *Issue:* What should each of the parties do now?

HELD: “The defendant must restore and deliver possession of the land described in the complaint to the Municipality of Cavite, which in turn must restore to the said defendant all the sums it may have received from her in the nature of rentals just as soon as she restores the land improperly leased.”

- (b) If a sale of land is annulled, the seller must return the purchase price with legal interest and the buyer must return the land with its fruits. (*Labrador v. De los Santos*, 66 Phil. 579 and *Dumasug v. Modelo*, 34 Phil. 252).
- (c) However, in the case of *Laperal v. Rogers*, L-16590, Jan. 30, 1965, the Supreme Court held that the buyer of a parcel of land does *not* have to pay rent, during the time he is in possession (even if the sale is eventually cancelled) for the simple reason that the seller was himself already enjoying the use of the money, delivered to such seller, as the purchase price. The Court further held that in the absence of a showing that there is considerable disparity in the benefits derived by both parties, equity will presume that they are, more or less, the same.

Tan Queto v. Court of Appeals **GR 35648, May 16, 1983**

If a husband barter away his wife’s paraphernal property, the barter has “no effect,” if his wife did not

consent to the transaction. The person who acquires the land knowing that the same is owned by the wife and constructs a building thereon may be regarded as a builder in bad faith. He can, therefore, recover *no* reimbursement for such construction. (*Art. 449, Civil Code*).

(3) Non-availability to Strangers

Art. 1398 *cannot* be availed of by strangers to the contract. (*Gov't. v. Wagner, 5 Phil. 132*). Innocent third parties cannot be obliged to restore. (*Dia v. Finance & Mining, Inc., Corp., [C.A.] 46 O.G. 127*).

(4) Effect of Registration of the Land

Even if the land has already been registered, Art. 1398 still applies, provided there has been no estoppel. (*Tinsay v. Yusay and Yusay, 47 Phil. 639*).

(5) Extra Liability of the Guilty Party

A guilty party who, for example, used force can be held liable for damages under Arts. 20 and 21 of the Civil Code:

Art. 20. Every person who, contrary to law, willfully, or negligently causes damage to another, shall indemnify the latter for the same.

Art. 21. Any person who willfully causes loss or injury to another in a manner that is contrary to morals, good customs or public policy shall compensate the latter for the damage.

(6) Personal Obligations

Here the value of the service shall be the basis for damages. (*Art. 1398, 2nd par.*).

Art. 1399. When the defect of the contract consists in the incapacity of one of the parties, the incapacitated person is not obliged to make any restitution except insofar as he has been benefited by the thing or price received by him.

COMMENT:**(1) Generally, No Restitution by Incapacitated Party**

- (a) The Article applies *only* if the defect is INCAPACITY.
- (b) This constitutes an exception to the obligation of mutual restitution under Art. 1398.
- (c) Here in Art. 1399, restitution is only to the extent of *enrichment* (pecuniary or otherwise).

(2) No Presumption of Enrichment

The law does not presume this enrichment or benefit; therefore, the *capacitated* person has the burden of showing such enrichment. Just because the property had been delivered, it does not necessarily follow that there was enrichment. (*TS, Oct. 22, 1984*).

Of course, if the incapacitated person still has the property, this by itself is a benefit which he must return and *not* squander; otherwise, this will amount to a ratification. (*Uy Soo Lim v. Tan Unchuan, 38 Phil. 552*).

(3) Case

Uy Soo Lim v. Tan Unchuan
38 Phil. 552

FACTS: A, a minor, entered into a contract with a person *sui juris*. After reaching majority he squandered the money received. *Issue:* Why is this an implied ratification?

HELD: “The privilege granted minors in disaffirming their contracts upon reaching the age of majority is subject to prompt election on the matter. . . The exception of infants from liability on their contracts proceeds solely upon the principle that such exemption is essential to their protection, and the law of infancy should be so administered that the result may be secured. But it has not infrequently happened that courts, in their anxiety to protect the rights of infants in the matter of contracts made by them during non-age, have, after they have become adults, treated them to the same extent as infants still, exempting them

from the operation of the rules of law. The strong tendency of the modern decision, however, is to limit the exemptions of infancy, to the principle upon which the disability proceeds.”

(4) The Capacitated Person Must Restore Whether He Benefited or Not, Except if Art. 1427 of the Civil Code Applies

Art. 1427 reads: “When a minor between 18 and 21 years of age who has entered into a contract without the consent of the parent or guardian *voluntarily pays* a sum of money or delivers a fungible thing in fulfillment of the obligation (natural obligation), there shall be no right to recover the same from the obligee who has *spent or consumed it in good faith*.”

Art. 1400. Whenever the person obliged by the decree of annulment to return the thing cannot do so because it has been lost through his fault, he shall return the fruits received and the value of the thing at the time of the loss, with interest from the same date.

COMMENT:

(1) Value May Be Substituted for Thing Itself

In the duty of mutual restitution, the *value* of the thing with interest substitutes for the *thing itself* that was lost through the party’s *fault*.

(2) Example

A forced B to sell him (A) the house of B. B brought an action to annul the contract. The contract was annulled on the ground of fraud. A was asked by the court to return to B whatever he (A) has received. But the house had been destroyed through the fault of A. What should A now give?

ANS.: A should give all of the following:

- (a) the fruits or rentals of the house received from the time the house was given to him to the time of its loss;

- (b) the value of the house at the time of the loss;
- (c) interest at 6% *per annum* on the value of the house from the time the house was destroyed.

(3) Case

Dumasug v. Modelo 34 Phil. 252

FACTS: A contract between *A* and *B* was annulled by the court. But the object of the contract, a carabao, had died while in *B*'s possession. *Issue:* What should *B* return?

HELD: "With respect to the plow carabao that died while in defendant's possession, the value of which is P120, defendant is obliged pursuant to the provision of Art. 1307 (now Art. 1400 of the New Civil Code) to pay and deliver to plaintiff the value of said animal, with interest as an indemnity for the detriment caused to its owner."

Art. 1401. The action for annulment of contracts shall be extinguished when the thing which is the object thereof is lost through the fraud or fault of the person who has a right to institute the proceedings.

If the right of action is based upon the incapacity of any one of the contracting parties, the loss of the thing shall not be an obstacle to the success of the action, unless said loss took place through the fraud or fault of the plaintiff.

COMMENT:

(1) Historical Notes on Effect of Loss of Object Through Fraud or Fault of the Victim

- (a) This is a substantial restatement of Art. 1314 of the old Civil Code, except that the phrase "after having acquired capacity" after the word "plaintiff" in the second paragraph has been omitted, implying that under the new Civil Code, fraud or fault on the part of the aggrieved party may exist even during his minority. Whereas Art. 1401 of the new Civil Code refers to fraud or fault on the part of the person

who can bring the action for annulment, Art. 1400 of the new Civil Code refers to the fault on the part of the person who cannot bring the action to have the contract declared annulled.

- (b) As things now stand, the two paragraphs in Art. 1401 mean the same thing.

(2) Query on Squandering by Insane Person

An insane person sold his house, and squandered the proceeds while insane. Can he ask for annulment later on and recover the house?

ANS.: Under the second paragraph of Art. 1401, he cannot sue for annulment and recover the house because the proceeds were squandered away by him. Thus, according to the members of the Code Commission, the action cannot prosper, even if at the time of loss, the plaintiff was still insane or a minor. (*Memo-randum to the Joint Congressional Committee on Codification, Mar. 8, 1951*).

AND YET, this *would contradict* Art. 1399, because there, the incapacitated person is not obliged to make any restitution *except insofar* as he has been *benefited* by the thing or price received by him. Being insane, he could *not* have profited by squandering the money.

It is thus believed that the answer of the Code Commission is NOT accurate for even were we to apply Art. 1401 (2nd paragraph), it is clear that the loss during the insanity could not be due to “fraud” or “fault.”

(3) Problems

- (a) A was forced to sign a contract with B. In said contract, A was given a house. But A destroyed the house. May A still bring the action for annulment?

ANS.: No more. His act of destroying the house extinguished his right to bring the action for annulment.

- (b) A, a minor, was sold a house by B. The house was destroyed by a fortuitous event. May A still annul the contract so as to recover from B the price (and interest) he (A) had given?

ANS.: Yes. As a rule, if the right of action is based upon the incapacity of anyone of the contracting parties, the loss of the thing shall not be an obstacle to the success of the action. Here, the minor was *not* guilty of fraud or fault. (*Art. 1401, 2nd par.*)

Art. 1402. As long as one of the contracting parties does not restore what in virtue of the decree of annulment he is bound to return, the other cannot be compelled to comply with what is incumbent upon him.

COMMENT:

(1) Reason Why One Party Cannot Be Compelled if Other Party Does Not Restore

A reciprocal obligation of restitution has been created.

(2) Example

A forced B to take A's car in exchange for B's ring. B asked for annulment, and the court gave the decree of annulment ordering each to return what had been received. B refused to give A the car. May A be compelled to give back the ring? No.

(3) Effect of Loss Thru Fortuitous Event

Suppose the innocent party cannot restore because of a loss thru a fortuitous event, may he still compel the other to return what he had given?

ANS.: It would seem that the answer is NO, because before annulment, the contract is *valid*, and the innocent party, being the owner of the thing lost by a fortuitous event, must bear the loss. There is however an exception, and it occurs when he offers to give the value of the thing. (He does not have to give interest in view of the fortuitous event.) He must be allowed this remedy; otherwise, he would be in a worse position than one who had destroyed the thing thru his fault. Once he exercises this remedy, he can recover from the other what has been previously given.

(4) Problem

A forced *B* to sell to him (*A*) his (*B*'s) ring. *B* sued for annulment, but *A* had already lost the ring thru a fortuitous event. What is *B*'s remedy?

ANS.: *A* can be compelled to pay its value or damages, for it is as if *A* was a possessor in bad faith who bears the loss even in case of a fortuitous event. (*See Art. 1522, Civil Code*).

Chapter 8

UNENFORCEABLE CONTRACTS (n)

INTRODUCTORY COMMENT:

(1) Unenforceable Contracts Distinguished from Voidable and Rescissible Contracts

Unenforceable contracts cannot be sued upon or enforced unless ratified; thus, it is as if they have *no effect* yet. But they may be ratified; hence, they can have in such a case the effect of valid contracts. In one sense, therefore, they may be called *validable*.

Voidable and *rescissible* contracts, upon the other hand, produce legal effects until they are annulled or rescinded.

Thus, unenforceable contracts are nearer absolute nullity than the other two. (*See Report of the Code Commission, p. 130*).

(2) Kinds of Unenforceable Contracts

- (a) Unauthorized contracts.
- (b) Those that fail to comply with the Statute of Frauds.
- (c) Those where both parties are incapable of giving consent to a contract.

Art. 1403. The following contracts are enforceable, unless they are ratified:

(1) Those entered into in the name of another person by one who has been given no authority or legal representation, or who has acted beyond his powers;

(2) Those that do not comply with the Statute of Frauds as set forth in this number. In the following cases an agreement hereafter made shall be unenforceable by action, unless the same, or some note or memorandum thereof, be in writing, and subscribed by the party charged, or by his agent; evidence, therefore, of the agreement cannot be received without the writing, or a secondary evidence of its contents:

(a) An agreement that by its terms is not to be performed within a year from the making thereof;

(b) A special promise to answer for the debt, default, or miscarriage of another;

(c) An agreement made in consideration of marriage, other than a mutual promise to marry;

(d) An agreement for the sale of goods, chattels or things in action, at a price not less than five hundred pesos, unless the buyer accept and receive part of such goods and chattels, or the evidences, or some of them, of such things in action, or pay at the time some part of the purchase money; but when a sale is made by auction and entry is made by the auctioneer in his sales book, at the time of the sale, of the amount and kind of property sold, terms of sale, price, names of the purchasers and person on whose account the sale is made, it is a sufficient memorandum;

(e) An agreement for the leasing for a longer period than one year, or for the sale of real property or of an interest therein;

(f) A representation as to the credit of a third person.

(3) Those where both parties are incapable of giving consent to a contract.

COMMENT:

(1) Unauthorized Contracts

(a) These are “those entered into in the name of another person by one who has been given *no authority* or legal representa-

tion, or who has acted beyond his powers.” (*Art. 1403, No. 1*).

Leabres v. CA
GR 41847, Dec. 12, 1986

A supposed sale of a piece of land belonging to the estate of the deceased under *custodia legis* of the Probate Court made by the Special Administrator in his own personal capacity and without court approval cannot bind the estate. The “buyer” should have submitted the receipt of the alleged sale to the Probate Court for its approval of the transaction in order that his right over the subject land could be recognized, assuming that the receipt could be regarded as sufficient proof.

(b) *Example:*

Without my authority, my brother sold my car, in my name, to X. The contract is unauthorized and cannot affect me unless I ratify the same expressly or implicitly, as by accepting the proceeds of the sale.

Bumanlag v. Alzate
GR 39119, Sept. 26, 1986

A compromise agreement signed in behalf of the client by his lawyer who did so without authorization of said client is merely unenforceable (not void) and may, therefore, be ratified by said party expressly or implicitly.

- (c) Mere lapse of time, no matter how long, is not the ratification required by law of an unenforceable contract. (*Tipton v. Velasco*, 6 *Phil.* 67).
- (d) Without ratification, the “agent” assumes personal liability. (2 *Am. Jur.* 251).

(2) The Statute of Frauds

- (a) *Purpose* — to prevent fraud, and not to encourage the same. Thus, certain agreements are required to be in writing so that they may be enforced. (*See Shoemaker v. La Tondeña*, 68 *Phil.* 24).

**Heirs of Cecilio Claudel, et al. v.
Court of Appeals
GR 85240, Jul. 12, 1991**

FACTS: As early as December 28, 1922, Basilio *a.k.a.* Cecilio Claudel acquired from the Bureau of Lands a 10,107 sq. meter lot. He secured a transfer certificate of title for it in 1933. He declared the lot in his name and paid the real estate taxes thereon until his death in 1937. Thereafter, his widow Basilia and later, her son Jose, one of the petitioners, paid the taxes. Two brothers of Cecilio's family contested the ownership over the land. On one hand the children of Cecilio, the petitioners, the Heirs of Cecilio, and on the other hand, his brothers and sisters, the Siblings of Cecilio. In 1972, the Heirs of Cecilio partitioned the lot among themselves and obtained the corresponding titles on their shares. Four years later, on Dec. 7, 1976, the Siblings of Cecilio filed a complaint for cancellation of titles and reconveyance with damages, alleging that in 1930 their parents bought from Cecilio several portions of the lot for P30. They admitted that the transaction was verbal. However, as proof of the sale, the Siblings of Cecilio presented a subdivision plan of the land, dated Mar. 25, 1930, indicating the portions allegedly sold to the Siblings. The trial court dismissed the complaint, disregarding the sole evidence (subdivision plan) presented by the Siblings. The Court of Appeals reversed the trial court on the following grounds: (1) the failure to bring and prosecute the action in the name of the real party in interest, namely, the parties themselves, was not a fatal omission since the court *a quo* could have adjudicated the lots to the siblings, the parents of the heirs, leaving it to them to adjudicate the property among themselves; (2) the fact of residence in the disputed property by the heirs had been made possible by the toleration of Cecilio; (3) the Statute of Frauds applies only to executory contracts and not to consummated sales as in the case at bar where oral evidence may be admitted; (4) the defense of prescription cannot be set up against the Siblings despite the lapse of over 40 years from the time the alleged sale in 1930 up to the filing of the complaint for cancellation and reconveyance in 1976. The action, said the

Court of Appeals, was not for the recovery of possession of real property but for the cancellation of titles issued to the heirs in 1973. Since the Siblings commenced the complaint for cancellation of titles and reconveyance with damages on Dec. 7, 1976, only four years after the heirs partitioned the lot among themselves and obtained the corresponding transfer certificates of titles, then there is no prescription of action yet. So, the Court of Appeals ordered the cancellation of the Transfer Certificates of Title issued in the names of the heirs and, corollarily, the execution of the deeds of reconveyance in favor of the siblings.

ISSUES: Whether a contract of sale of land may be proven orally; and whether the prescriptive period for filing an action for cancellation of titles and reconveyance with damages should be counted from the alleged sale upon which they claim their ownership in 1930 or from the date of the issuance of the titles sought to be cancelled in favor of the heirs in 1976.

HELD: The Supreme Court reversed the decision of the Court of Appeals, and reinstated that of the trial court, which ruled for the dismissal of the suit for cancellation of titles and reconveyance. It held that a sale of land, once consummated, is valid regardless of the form it may have been entered into. Nowhere does law and jurisprudence prescribe that the contract of sale be put in writing before such contract can validly cede or transmit rights over a certain real property between the parties themselves. But if a third party, as in this case, disputes the ownership of the property, the person against whom that claim is brought cannot present any proof of such sale and, hence, has no means to enforce the contract. Thus, the statute of frauds was precisely devised to protect the parties in a contract of sale of real property so that no such contract is enforceable unless certain requisites, for purposes of proof, are met. Therefore, except under the conditions provided by the Statute of Frauds, the existence of the contract of sale made by Cecilio with his siblings cannot be proved. The belated claim of the siblings who filed a complaint only in 1976 to enforce a right acquired allegedly as early as 1930, is difficult to comprehend. The Civil Code states: The fol-

lowing actions must be commenced within six years: (1) upon an oral contract. If the Siblings had allegedly derived their right of action from the oral purchase made by their parents in 1930, then the action filed in 1976 would have prescribed. More than six years had elapsed.

(b) *How the Statute of Frauds Prevents Fraud*

Since memory is many times unreliable, oral agreements may sometimes result in injustice. To aid human memory, to prevent the commission of injustices due to faulty memory, to discourage intentional misrepresentations, are the principal aims of the Statute of Frauds. (*Facturan v. Sabanal*, 81 Phil. 512).

(c) *First Country to Enact Statute*

England was the first country to adopt a Statute of Frauds. In 1676, the English Parliament passed a law or statute requiring certain agreements to be in writing. Since that time, the statute has been called Statute of Frauds. (*National Bank v. Philippine Vegetable Oil Co.*, 49 Phil. 857).

(d) *History, Chief Characteristics, and Object of the Statute of Frauds:*

- 1) The Statute of Frauds is the common designation of a very celebrated English Statute (29 Car II C, 3), passed in 1676, and which has been adopted in a more or less modified form, in nearly all of the United States (and in the Philippines).
- 2) Its chief characteristic is the provision that no suit or action shall be maintained on certain classes of contracts or engagements unless there is a note or memorandum thereof in writing signed by the party to be charged or by his authorized agent.
- 3) Its object was to close the door to the numerous *frauds* which were believed to be perpetrated and the *perjuries* which were believed to be committed when such obligations could be enforced upon no other evidence than the mere recollection of witnessess. It is more fully named as “the Statute of Frauds and Perjuries.”

(*Black's Law Dictionary*, pp. 813-814; *Smith v. Morton*, 70 Okl. 157, 173, pp. 520, 512; and *Houseley v. Strawn Merchandise Co.*, [Tex. Com. App.] 291 S.W. 864, 867).

(e) *Some Basic and Fundamental Principles Concerning the Statute of Frauds (General Rules of Application)*

- 1) The Statute of Frauds applies only to executory contracts (contracts where no performance has yet been made) and not partially or completely executed (consummated contracts). (*Almirol & Carino v. Monserrat*, 48 Phil. 67; *Asturias Sugar Central, Inc. v. Montinola*, 69 Phil. 725 and *Facturan v. Sabanal*, 81 Phil. 512). If oral evidence will not be allowed to prove an agreement where one party has performed his obligation, unfairness would result. (*National Bank v. Phil. Veg. Oil Co.*, 49 Phil. 857). Indeed, oral or parol evidence may be introduced to prove partial performance. If documentary or written evidence would still be required for the proof of partial performance, the precise evil sought to be avoided by the Statute of Frauds would be present, namely, one who has received some benefits would be allowed to defraud the grantor thereof. (*Carbonel v. Poncio, et al.*, L-11231, May 12, 1958).
- 2) The Statute of Frauds cannot apply if the action is *neither* for *damages* because of the *violation* of an agreement nor for the *specific performance* of said agreement. (*Lim v. Lim*, 10 Phil. 635 and *Facturan v. Sabanal*, 81 Phil. 512).
- 3) The Statute of Frauds is exclusive, that is, it *applies only* to the agreements or contracts enumerated herein. (See *Quintos v. Morata*, 54 Phil. 481; also the rule of Statutory Construction which states: "*Inclusio unius est exclusio alterius*" – what the law does not include, it excludes. Or, the enumeration of certain things excludes all those not so enumerated.)
- 4) The defense of the Statute of Frauds may be waived. (See Art. 1405, Civil Code; see also *Conlu v. Araneta &*

Guanko, 15 Phil. 387; *Magalona v. Parayco*, 59 Phil. 453; and *Tangco v. Vianzon*, 50 Phil. 698).

- 5) The Statute of Frauds is a personal defense, that is, a contract infringing it cannot be assailed by third persons. (*Art. 1408, Civil Code*; see *Moore v. Crawford*, 130 U.S. 122).
- 6) Contracts infringing the Statute of Frauds are not void; they are merely unenforceable. (*Art. 1403, Civil Code*).
- 7) The Statute of Frauds is a Rule of Exclusion, *i.e.*, oral evidence might be relevant to the agreements enumerated therein and might therefore be admissible were it not for the fact that the law or the statute excludes said oral evidence. (*See Jones on Evidence, Sec. 1425*).
- 8) The Statute of Frauds does *not* determine the *credibility* or *weight* of evidence. It merely concerns *itself* with the *admissibility* thereof.
- 9) The Statute of Frauds does *not* apply if it is claimed that the contract does not express the true agreement of the parties. As long as the true or real agreement is not covered by the Statute of Frauds, it is provable by oral evidence. (*Cayugan v. Santos*, 34 Phil. 100).

(3) Examples of the First Principle — The Statute of Frauds applies only to *executory* contracts:

- (a) *A* sold to *B* real estate for a stipulated price. The agreement was oral. *A* has not yet delivered the real estate. *B* has not yet paid the price. *B* offered to buy, but *A* refused to go ahead with the agreement. Under the Statute of Frauds, to be enforceable, an agreement for the sale of real estate must be in writing (*Art. 1403, [2e]*); *B* sued for specific performance. *A*'s attorney objected, setting up the Statute of Frauds as the reason for the objection. May the contract be proved by oral evidence?

ANS.: No. The agreement being merely executory, the agreement cannot be proved. Therefore also, *A* cannot be compelled to deliver. (*See Santos v. Rivera*, 33 Phil. 1).

[NOTE: Had A's attorney not objected, the defense would have been waived, and specific performance could have been ordered. (*Art. 1405, Civil Code and Conlu v. Araneta & Guanko, 15 Phil. 387*).]

- (b) Suppose in problem (a), the price had already been paid, would your answer be the same?

ANS.: No, the answer would not be the same. Here the objection of A's lawyer will not prosper. The Statute of Frauds will not apply because the contract has already been executed or performed, at least on the side of B. (*See Almirol, et al. v. Monserrat, 48 Phil. 67; Robles v. Lizarraga Ramos, 50 Phil. 387; see also Art. 1405 of the Civil Code which says that "contracts infringing the Statute of Frauds . . . are ratified . . . by the acceptance of benefits under them."*)

[NOTE: Why is the Statute applicable only to executory contracts and not to those fully or partially performed?

ANS.: Because the possibility for fraud in executory contracts is much greater. As a result, were the rule otherwise, many would perjure themselves on the witness stand. (*See Hernandez v. Andal, 78 Phil. 196; see also Chason v. Cheeley, 6 Ga. 554*).]

- (c) By virtue of an oral contract of sale, seller delivered to buyer a piece of land which was partially paid. May seller recover balance of price?

ANS.: Yes, since the contract has already been partially executed. (*Almirol & Carino v. Monserrat, 48 Phil. 67*).

- (d) Through the failure of the would-be buyer, the Manila Railroad Co., to accept the deed after having orally offered to buy the house subjected the plaintiff (would-be seller) to much trouble and annoyance and may therefore be subject to criticism, still plaintiff has no cause of action for the Statute of Frauds has been timely pleaded in defense by the Railroad Co. (*Barreto v. Manila Railroad Co., 46 Phil. 964*).
- (e) Statute of Frauds applies only to executory contracts and their enforcement. Both the extensions of the period of

repurchase and the extensions of the lease contracts are no longer executory, because they have already been performed and consummated. (*Goejin v. Libo*, L-4250, Aug. 21, 1953).

Maria Paterno, et al. v. Jao Yan
L-12218, Feb. 28, 1961

FACTS: A written contract of lease was made for seven (7) years with the lessee binding himself to construct a building of strong WOODEN materials on the leased premises, which would later become the property of the lessor at the end of the lease. Instead of constructing a wooden structure, the lessee built a SEMI-CONCRETE one of much bigger value, allegedly because of an ORAL extension of the lease to ten (10) years, instead of the original seven years. *Issue:* May testimonial evidence be given in support of such ORAL extension?

HELD: Yes, for partial performance takes an oral contract out of the scope of the Statute of Frauds. (27 C.J. 206 and *Hernandez v. Andal*, 78 Phil. 196). The rule applies to a lease where the taking of possession and the making of valuable improvements and the like on the faith of an oral agreement makes the statute inapplicable; otherwise, fraud will be committed against lessee. Oral testimony may thus be admitted to show that partial performance has been made.

(4) Examples of Principle No. 2 — The Statute of Frauds is not applicable when the action is neither for damages because of the violation of an agreement nor the specific performance of said agreement.

- (a) Tenant and landlord had an oral contract of lease for two years. [Under the Statute, to be enforceable, this must be in writing (*Art. 1403, No. 2*).] It was also orally agreed that half of the crops should belong to the tenant; the other half, to the landlord. Landlord, in violation of this agreement, sold all the crops and refused to give tenant the latter's share. Statute of Frauds in defense. Decide.

ANS.: Tenant can recover. While it is true that the lease should have been in writing, tenant is not asking for damages because of the breach of the contract of lease. (As a matter of fact, he was occupying the land.) Rather, the tenant is asking for damages, because of the violation of the agreement regarding the crops. Statute of Frauds is not therefore applicable. (*Lim v. Lim*, 10 Phil. 635).

- (b) Landlord orally agreed with tenant that the former would sell for a certain price the house occupied by tenant to the latter, at the end of the lease. Because of said agreement, tenant introduced improvements amounting to P4,500. When lease expired, landlord wanted a higher rent. Tenant refused. Tenant wants to recover the value of the improvements, and tries to prove the oral agreement of sale. Landlord sets up the Statute of Frauds. Decide.

ANS.: Tenant can prove by parol (oral) evidence the oral agreement of sale; after all he was not interested in the sale, but merely brought it out to justify his claim for reimbursement for the improvements introduced. (*Robles, et al. v. Lizarraga, et al.*, 42 Phil. 584).

- (c) Where the purpose of the action was to enforce an alleged verbal agreement to *sell* to the plaintiff a parcel of land which is claimed to have been occupied by the plaintiff as a *tenant* since 1912, the court dismissed the case on motion to dismiss, it appearing that under the Statute of Frauds, said verbal agreement cannot be enforced, nor evidence thereon presented, because it has not been made in writing, nor does it appear in a note or memorandum as required by said Statute. (*Pascual v. Realty Investment, Inc.*, 91 Phil. 257).

BUT where a parol (oral) contract of sale is adduced not for the purpose of enforcing it, but *as a basis of the possession* of the person claiming to be the owner of the land, the Statute of Frauds is *not* applicable.

- (d) Where the complaint does not contain allegations to the effect that the plaintiff has taken possession of land in view of the supposed verbal contract he had with the defendant to purchase it, nor is there any allegation that the plaintiff has made improvements thereon because, and as

a consequence, of said supposed contract to sell; and on the contrary, it alleges that plaintiff occupied the land as a tenant since 1912, the alleged transaction of “sale” comes under the Statute of Frauds. (*Ibid.*).

(5) Examples of Principle No. 3 — The Statute of Frauds is exclusive, that is, it applies only to the agreement or contracts enumerated therein:

- (a) A loan of P1,000 does not have to be in writing to be enforceable because the contract of loan is not one of those enumerated in the Statute. Hence, an oral loan of P1,000 is valid and enforceable.
- (b) An oral sale of a transistor radio for P400 is valid and enforceable, since the price is less than P500. (*See Art. 1403, No. 2-d*).
- (c) A defect in the attestation clause of a will was being cured by oral evidence. *No* objection was made. Has the defect been cured?

ANS.: No, the defect has not been cured. *Reason:* The Statute of Frauds, its defenses, and its waiver are not applicable to wills because the Statute of Frauds refers only to certain contracts and agreements, whereas the subject of wills and testaments and the formalities which surround their execution are governed by separate and specific provisions of law. (*Quintos v. Morata, 54 Phil. 481*).

- (d) A mutual promise to marry is not governed by the Statute of Frauds; hence, it may be made orally. (*See Art. 1403, No. 2[a]*). Note however, that even if oral promise to marry is actionable in case of breach, only damages may be recovered, *not* specific performance, for specific performance is generally not a remedy in personal obligations. (*See Arts. 1167 and 1170, Civil Code*).

(6) Examples of Principle No. 4 — The defense of the Statute of Frauds may be waived:

- (a) In an oral executory contract of the sale of realty, if one party fails to timely object to oral evidence presented by

the other, it is as if there was a waiver, and the agreement can be considered completely valid, provided all the other essential requisites for the transaction are present. (*See Conlu v. Araneta, et al.*, 15 Phil. 387 and *Macfarlane v. Green*, 54 Phil. 551).

- (b) There are two ways to waive this defense:
 - 1) Timely failure to object to the presentation of oral evidence to prove the oral agreement.
 - 2) Acceptance of benefits under them (as when contract is totally or partially performed). (*See Art. 1405, Civil Code*).
- (c) What is meant by a timely objection, or when must the objection be made?

ANS.: Either after the *question* about the agreement is made or after the *answer* to said question is made: *after the question*, if from the question the expected answer is obvious; *after the answer*, if the question itself did not reveal the answer. If, for example, the question is “DID you enter into the contract of sale?” here obviously, a sale (oral) is about to be proved and objection must at once be made; if the objection is raised only after the answer “Yes we entered into it on Jul. 1, 1951,” the objection is no longer timely, and the defense of the Statute of Frauds should be deemed waived. (*See Abrenica v. Gonda, et al.*, 34 Phil. 739). Had the objection been timely, the oral evidence of the sale should have been inadmissible. (*See Barretto v. Manila Railroad Co.*, 46 Phil. 964).

- (7) Example of Principle No. 5** — The Statute of Frauds is a personal defense, that is, an agreement infringing it cannot be assailed by third persons.

Problem: Tenant was occupying landlord’s house on a lease contract when landlord sold the house to a buyer orally. The buyer has not yet given the price and the seller has not delivered the house. If buyer asks tenant to pay the rent to him, and tenant refuses on the ground that the sale is unenforceable, will the tenant’s contention prosper?

ANS.: No, because not being a party to said sale, he cannot set up the Statute of Frauds. (*See Art. 1408, Civil Code; see also Moore v. Crawford, 130 U.S. 122*).

- (8) Example of Principle No. 6** — Contracts infringing the Statute of Frauds are not void; they are merely unenforceable.

A and B entered into an oral executory sale. The sale is not void, for if this were so, it cannot be ratified. As in the example given in No. (7), the contract of sale had also some effect, namely, that the tenant cannot refuse to pay rent to the new landlord-buyer.

- (9) Example of Principle No. 7** — The Statute of Frauds is a rule of exclusion.

A orally sold B a piece of land. Agreement was still executory. A asked for payment. B refused, setting up Statute of Frauds. In the court action, A had 2 witnesses who were ready to testify that they were present when the agreement was made. Their testimony would indeed be relevant, but should there be timely objection on the part of B's attorney, their evidence would not be admissible because the Statute of Frauds *excludes* such testimony on a matter like this.

- (10) Example of Principle No. 8** — The Statute of Frauds does not determine the credibility or the weight of evidence. It merely concerns itself with the *admissibility* thereof.

To prove an oral sale of land, X wanted to present the oral testimony of cabinet members, all of whom are men of integrity. Although they may be very truthful, still their evidence will *not be admitted*.

- (11) Example of Principle No. 9** — The Statute of Frauds does not apply if it is claimed that the contract does not express the true agreement of the parties. As long as the true or real agreement is *not covered* by the Statute of Frauds, it is provable by oral evidence.

A orally sold B a ring allegedly for P700. The contract is unenforceable, but if A insists that the price was only P400, oral evidence is allowed.

(12) The Specific Agreements

There are six specific agreements referred to under the Statute of Frauds. Each one will be illustrated or explained herein below.

(13) Illustration of Specific Agreement No. 1 — “An Agreement that by its terms is not to be performed within a year from the making thereof.” (*Art. 1403, No. 2-a, Civil Code*).

- (a) *A* and *B*, neighbors, orally agreed that *A* would sell and *B* would buy *A*'s transistor radio for P200 *three years* from the date of the agreement. At the end of three years, *A* refused to hand over the radio although *B* was willing to pay. Is the agreement enforceable under the Statute of Frauds?

ANS.: No, because under the terms of the contract, the sale was to be performed at the end of three years. It should have been, therefore, made in writing. The Statute recognizes the frailty of man's memory, and apparently only 1 year is the limit.

Had the agreement been that performance would be made within *three months*, the agreement, even if oral, would have been enforceable. (*See Boydell v. Drummond, 11 East 142*).

- (b) *A* and *B*, neighbors, orally agreed that from that day, *B* would not erect a garage on his property till after three years. A week later, *B* began to erect the garage in violation of the agreement. *A* complains and *B* sets up the Statute of Frauds. Decide.

ANS.: *A* is correct in complaining. This agreement does not come under the Statute of Frauds, because here the performance was to begin right on that day they agreed, namely, the obligation not to construct. This is *not* an agreement that will be performed after a year; performance was to begin right away. (*See Art. 1403 [No. 2-a], Civil Code.*)

- (c) A servant had an oral contract which allowed him P10 a month salary. He served continuously for twelve years. Master refused payment on the ground that the contract having lasted for more than 1 year, the same should have

been in writing to be enforceable. *Question*: Is the servant entitled to be paid?

ANS.: Yes. Firstly, the Statute of Frauds (*Art. 1403, No. 2-a*) is not applicable because here the performance began right away; there was *no* postponement of performance for a year. Secondly, the Statute is not applicable to executed or partially executed contracts. Thirdly, the Statute was designed to prevent, not foster, fraud. To prevent the servant from collecting would be to encourage the commission of fraud. (*See Arroyo v. Azur, et al., 76 Phil. 493*).

- (d) *A* and *B* orally agreed in 2006 to marry each other in 2000. When 2010 came, *A* refused to marry *B*, who now seeks damages. *Question*: Would *B* be allowed to prove the oral agreement?

ANS.: No, because since the performance was to be made 4 years after the agreement, it had to be in writing to be enforceable. Having been made orally, it cannot be proved over and above the objection of *A* or *A*'s counsel. [*See Atienza v. Castillo, et al., 71 Phil. 589*; *J. Moran* dissented on the ground that in a mutual promise to marry, it does not matter how long the marriage is deferred because the first agreement in the Statute is not applicable but the third agreement does apply — “An agreement made in consideration of marriage, *other than a mutual promise to marry*” (*no period of time being stated*).]

- (e) *When Applicable and When Not Applicable*

“The broad view is that the Statute of Frauds applies (in this agreement) only to agreements not to be performed on either side within a year from the making thereof. Agreements to be fully performed on one side within a year are taken out of the operation of the Statute. The Statute of Frauds was enacted for the purpose of preventing frauds. It should not be made the instrument to further them.” (*Nat. Bank v. Phil. Veg. Oil Co., 49 Phil. 857*).

Babao v. Perez, et al.
L-8334, Dec. 28, 1957

FACTS: An oral agreement was entered into in 1924 which allegedly required plaintiff Babao to improve 156

hectares of forest lands by levelling and planting thereon coconuts, rice, corn and *other* crops such as bamboo and banana trees, as well as to act as administrator of said land. In return, the defendant Perez bound herself to give and deliver to Babao or his wife *one-half* of the whole area of the land as improved, with all the improvements thereon, *upon* her death. Perez died in 1947. A witness testified that Perez had told Babao, "You leave the Ilana estate, and attend to this land. Have it cleared and planted to coconut, for that land will eventually fall in your hands." A very small portion of the land was then improved with certain crops. *Issue*: May Babao, after the owners' death, get the half-share allegedly promised him?

HELD: No, because the contract is unenforceable and cannot be proved by parol or oral evidence. Even if Babao had *partially* performed the contract within one year from the making thereof, still the Statute would apply, because, *in order that partial performance of the contract may take the case out of the operation of the Statute, it must appear clearly that full performance had been made by one party within one year*. All that is required is *complete* performance has been made by *one party*, *no matter* how many years may have to elapse before the agreement is performed by the other party, *but nothing less than full performance by one party will suffice*. If anything remains still to be done after the expiration of the year besides the mere payment of money, the Statute will apply. (*Shoemaker v. La Tondeña*, 68 Phil. 24 and *Nat. Bank v. Phil. Vegetable Oil Co.*, 49 Phil. 857, 858).

Even if we were to consider the case as one of sale (in which case, ordinarily *partial* performance by *one party* could make same enforceable), still it cannot be contended that the Statute will not apply, for here the agreement (to be one of sale) must be *certain, definite, clear and unambiguous*. Moreover, it should be *fair and reasonable*. For after all, the Statute is based on equity. In this case here, it is not clear exactly how many hectares would be planted to corn, how many with rice, how many with bamboo trees, *etc.* Had Babao planted a very small portion with corn and

rice, and the rest with bamboos and bananas, it is clearly *unjust* to give him *half of the entire property*.

(NOTE: It would seem from this case that while in *general* partially executed contracts are NOT covered by the Statute of Frauds, still under “No. 1, specific agreement,” only *full or complete* performance by one side will take the case out of the operation of the Statute.)

(14) Illustration of Specific Agreement No. 2 — “A special promise to answer for the debt, default, or miscarriage of another.” (Art. 1403, No. 2-b, Civil Code).

- (a) A borrowed money from B, with C as guarantor. The contract of guaranty between B, the creditor, and C, the guarantor, must be in writing to be enforceable. (See *Gull v. Lindsay*, 4 Ech. 45).
- (b) “Special promise” refers to a subsidiary or *collateral promise to pay*, like a contract of *guaranty*. (See *Brown v. Coleman Dev. Co.*, 34 Ont. L-210).
- (c) A was having his house repaired by B, who needed certain materials. So A told storeowner (of materials), “Give B the materials. I shall be responsible. I shall stand good.” This was orally made. Is this a special promise? Is this oral agreement enforceable?

ANS.: This is not a special promise. This is *not* a guaranty. Only A obligated himself. Since this is not a guaranty, the contract is enforceable, so that the seller can properly sue A and prove the oral agreement by *parol evidence*, over and above A’s objection. (See *Reiss v. Memije*, 15 Phil. 350).

- (d) A asked B to purchase certain properties from C who was orally assured by A that he (A) would pay for them. Later C sued A, who pleaded in defense the Statute of Frauds. Decide.

ANS.: The promise is *enforceable* even if orally made, for A was *not* guaranteeing another’s debt. He merely promised to pay HIS OWN debt. (*Colbert v. Bachrach*, 12 Phil. 83).

(15) Illustration of Specific Agreement No. 3 — “An agreement made in consideration of marriage other than a mutual promise to marry.” (*Art. 1403, No. 2-c, Civil Code*).

- (a) Examples of agreements *made in consideration of marriage*:
 - 1) marriage settlements. (*Art. 122, Civil Code*).
 - 2) donations *propter nuptias*. (*Art. 127, Civil Code*).
- (b) When the law says “in consideration of marriage,” it really means “*by reason of the marriage*.” Thus, the cause of the donation *propter nuptias* is *not* the marriage but the liberality or the generosity of the giver.
- (c) Note that the law says “other than a *mutual promise to marry*.” Hence, an oral mutual promise to marry is not embraced by the Statute of Frauds. The injured party may present *oral* evidence of the promise in an action to obtain actual damages for breach thereof. (*Cabague v. Auxilio, 92 Phil. 294*).
- (d) *Example of the Exception*:

A and B mutually promised to marry each other. The promise need not be in writing unless the marriage be deferred till after the lapse of one year from the agreement. (*See Atienza v. Castillo, et al., 71 Phil. 589*). For breach of a mutual promise to marry, the groom may sue the bride for actual damages and oral evidence of such mutual promise is admissible. (*Cabague v. Auxilio, supra*).

Cabague v. Auxilio
92 Phil. 294

FACTS: A has a son B; C has a daughter D. A, B, C, and D agree together that B will marry D. The agreement is oral. **Issue:** If D later on refuses to marry B who has spent for the necessary wedding preparations, and A and B bring an action against C and D, will the action prosper?

HELD: A and C should step out of the picture because it was not they who mutually promised to marry each other and therefore, to be enforceable, the agreement should be in

writing. The agreement, insofar as the claim for damages is concerned, is enforceable between *B* and *D*, even if made orally only, because here it is a mutual promise to marry. In the case of *A* and *C*, the agreement should have been reduced to writing because it is an agreement based on the consideration of marriage, other than a mutual promise to marry. (*See Art. 1403, No. 2-c, Civil Code*).

(16) Illustration of Specific Agreement No. 4 — “An agreement for the sale of goods, chattels, or things in action, at a price *not less than five hundred pesos unless . . .*” (*Art. 1403, No. 2-d, Civil Code*).

- (a) *A* sold *B* his pen for P400.00 orally. Contract was still executory. This is unenforceable unless *B* gets the pen or pays fully or partially for the price. (*See Art. 1403, No. 2 [d]; see also Engel, et al. v. Velasco & Co., 47 Phil. 115*).
- (b) Meaning of “things in action:” *incorporated or intangible personal property (Example: credit)*.
- (c) Note that the law says “sale,” *not* other contracts. (*Engel, et al. v. Velasco & Co., 47 Phil. 115*).
- (d) Note also that if the *price is exactly* P500, the contract must be in *writing* to be enforceable.
- (e) *Partial* payment takes the contract away from the Statute except if said part payment corresponds to the part delivered, in which case, if the contract is *divisible*, the remainder is *covered* by the Statute.
- (f) *Rule in case of auction sale:*

“When a sale is made by *auction*, and *entry* is made by the auctioneer in his sales book at the *time* of the sale, of

- 1) the *amount* and kind of property sold
- 2) the *terms* of the sale
- 3) the *price*
- 4) the *names* of the purchasers and persons on whose account the sale is made — the entry is considered a SUFFICIENT memorandum (even if the same is *not* signed by the party sought to be charged).”

(17) Illustration of Specific Agreement No. 5 — “An agreement for the *leasing* for a *longer* period than one year, or for the *sale* of real property or of an interest therein.” (*Art. 1403, No. 2-e, Civil Code*).

- (a) Two kinds of agreements are referred to here:
 - 1) *lease* of real property for *more than one year* (note of personal property)
 - 2) *sale* of real property (regardless of price)
- (b) *Example*:
 A is B’s tenant. Lease is for *six months*. If oral, lease is still enforceable, for the period does not exceed one year.
- (c) If lease of real property is *exactly* one year, the contract may be oral, since here the period does not exceed one year.
- (d) “Interest” in real property may include easement or usufruct.
- (e) A verbal agreement was made between A and B whereby A agreed to sell and B agreed to buy A’s farm for P100,000. The price was *paid*. Possession was not given nor was the deed delivered, both being refused. B comes to you and wants to know if he can compel A to give him the deed and possession. What would you advise?

ANS.: I would advise B to sue for specific performance and also ask A to execute the deed of conveyance. The Statute of Frauds refers only to purely executory contracts; hence the Statute will not apply in this case. (*See Art. 1403, No. 2 [e]; see also Facturan v. Sabanal, 81 Phil. 512*). Since the contract is *valid and enforceable*, we can now apply *Art. 1357 of the new Civil Code* which states that: “If the law requires a document or other special form, as in the acts and contracts enumerated in the following article, the contracting parties may compel each other to observe that form, once the contract has been perfected. This right may be exercised simultaneously with the action upon the contract.”

Western Mindanao Lumber Co., Inc. v. Medalle
L-23213, Oct. 28, 1977

The Statute of Frauds generally does not refer to the creation of an easement of right of way, the right not being the result of a sale of real property or interest therein.

Cruz v. J.M. Tuason and Co., Inc.
L-23749, Apr. 29, 1977

FACTS: *A* alleged that *B* promised to give him (*A*) 3,000 square meters of land in consideration of *A*'s services in a certain transaction. *B* pleads in defense that since the promise was not in writing, it is unenforceable under the Statute of Frauds.

HELD: The Statute of Frauds is inapplicable here, firstly because the promise to give the land is not a sale of real property or any interest therein, and secondly, because *A*'s services has already been performed. The Statute cannot apply to completely or partially executed contracts.

Syquia v. CA
GR 61932, Jun. 30, 1987

Under said article, all alleged oral assurances or promises of the representatives of the lessor that the lessee should be given priority or a renewal of the lease contract cannot be enforceable.

Also, under the parol evidence rule, the lessee's claim that he is entitled to a renewal of the contract of lease for the reason that the lessors had given him the option to renew the contract cannot be maintained.

(18) Illustration of Specific Agreement No. 6 — “A representation as to the credit of a third person.” (*Art. 1403, No. 2-f, Civil Code*).

A was borrowing money from *B*, and gave *C* as his reference. When *C* was asked regarding *A*'s credit *C* said: “You can safely lend money to *A* because *A* is the owner of a parcel of land and

I have the title deeds in my possession.” This was made orally. Incidentally, *A* was *C*’s client, *C* being a lawyer. This representation by *C* is not enforceable against him because it is not in writing. A representation as to the credit of a third person must be in writing to be enforceable. (*See Art. 1403, No. 2-f, Civil Code; see also Cook v. Churchman, 104 Ind. 141, 152*).

[NOTE: This must not be confused with a guaranty. Here no promise to answer for another’s debt is made; there is merely an assurance that somebody has a certain amount of credit, made with the intention of enabling the person in whose favor it is made to obtain credit by virtue of such assurance or representation. (*Reiss v. Memije, 15 Phil. 350*).]

[NOTE further that the person making the representation *does not* take part in the contract proper. However, his assurance to the person about to give credit may be considered some form of *agreement*. According to Justice J.B.L. Reyes and Justice Puno, however, “The liability . . . is *not ex contractu* but on *tort*. This number, therefore, is improperly included among unenforceable contracts. In fact, these representations were not included in the original Statute of Frauds (29 *Cas. II*) but were dealt with in Lord Tenterden’s Act (1828)” (9 *George IV C. 14*). (*Reyes & Puno, Outline of Civil Law, Vol. IV, p. 254*).]

(19) Express Trust Concerning Real Property

It will be observed that while the Statute of Frauds makes no mention of it, still under *Art. 1443* of the Civil Code, “no express trusts concerning an immovable or any interest therein may be proved by parol (oral) evidence.” Hence, we can safely conclude that the Statute of Frauds also applies to such express (conventional) trust.

(20) Duty of the Attorney for the Defendant

If an agreement violates the Statute of Frauds, but an action is nevertheless brought *against* one of the parties, his attorney can do the following:

- (a) File a motion to dismiss. (*Rule 16, 1997 Rules of Civil Procedure*);

- (b) Plead the Statute of Frauds as an affirmative defense. (*Sec. 6, Rule 6, New Rules of Civil Procedure*);
- (c) Make a timely objection in the course of the trial. (*See Art. 1405, Civil Code*).

(21) Duty of the Attorney for the Plaintiff

The lawyer for a person who *seeks* to enforce (or demand liability for) a contract embraced under the Statute of Frauds must do the following:

- (a) *Present the written agreement or contract;*
- (b) If this cannot be done, as when the contract is lost, present a *memorandum* or *note* in writing (this may be a page in a book or in a notebook, etc.) where the important details of the contract are set forth like description of the property, the names of the parties, etc., but most important of all, the party sought to be charged or his agent must have signed the note or memorandum. Unless there is the signature, the note or memorandum will be practically useless. So an entry in the diary of the seller is not the note or memorandum referred to in the law. (*Exception: in the case of "auction sale."*)
- (c) If the written agreement has been lost and there is no note or memorandum, there is still a remedy; present *secondary evidence* of the written agreement. This secondary evidence may of course be in the form of oral testimony or parol evidence. *But this does not mean that an oral contract is being proved.* The fact is, a *written contract* now lost or destroyed, is being proved orally. Before this can be done, of course, proof must be presented that at one time, there really existed said *written agreement*, and that said written agreement is now missing. After this, the contents of said missing document may now be proved by oral evidence. (*See Art. 1403 [No. 2], opening paragraph; see also 27 C.J. 259-260*).

(22) Problem on "Sufficient Memorandum"

A telegram was sent advising a *would-be buyer* to come to a certain place to complete the purchase of a parcel of land verbally promised to said buyer. BUT —

- (a) The telegram did not state the purchase price;
- (b) The telegram did not describe the property;
- (c) The telegram had not been signed by any authorized individual in behalf of the seller.

Question: Is the sale enforceable?

ANS.: No, because the telegram, as a note or memorandum, is clearly insufficient for the details above-mentioned were not placed. (*See Basa v. Raquel*, 45 *Phil.* 655).

(23) Meaning of Formal Requirements of “Sufficient Memorandum”

Our Supreme Court, consistent with a well-established doctrine, has held that no particular form of language or instrument is necessary to constitute a memorandum or note in writing under the Statute of Frauds; any document or writing under the contract or for another purpose, which complies with all the statutory requirements of the statute as to contents and signature, may be considered as sufficient memorandum or note. Thus, the memorandum may be written in pencil or in ink; it may be filled in or on a printed form. It does *not* have to be contained in a single instrument, nor, when contained in two or more papers, need each paper be sufficient as to contents and signature to satisfy the Statute. If there are two or more writings which are properly connected, they may be considered together; omissions in one may be supplied or clarified by the other, and their sufficiency will depend as to whether or not, when construed together, they are able to satisfy the requirement of the Statute of Frauds as to signature. (*Berg v. Magdalena*, 92 *Phil.* 110).

Berg v. Magdalena Estate 92 Phil. 110

FACTS: Berg and Hemady (representing the Magdalena Estate, Inc.), shortly after liberation, were accused of treasonable collaboration, and in the meantime, the Dept. of Treasury of the United States ordered their properties frozen under the Trading with the Enemy Act. This Act provided, among other

things, that the individuals whose assets were frozen were not allowed to sell, alienate, or otherwise dispose of their properties without prior permission from said Treasury Department. In view of this requirement, the two, Berg and Hemady, filed separately an application with the Department for the purchase and sale of the property being litigated upon, which covered the Crystal Arcade. This was done in January, 1946, where the selling price of P200,000 was fixed. The offer being accepted, the buyer was then given a period of time within which to pay. Buyer now asks for specific performance. Seller claims that there was no written contract of sale, pleading thus the Statute of Frauds in his defense. Decide.

HELD: The sale is enforceable because there was a sufficient note or memorandum evidenced by the applications for purchase and sale made by Hemady and Berg with the Treasury Department. Said applications constitute adequate proof to evidence the agreement being questioned. Furthermore, all the contractual requirements are present: parties, cause or consideration, and subject matter. (*See discussion in No. [23]*).

Cirilo Paredes v. Jose L. Espino
L-23351, Mar. 13, 1968

FACTS: Cirilo Paredes filed an action against Jose L. Espino to execute a deed of sale and to pay damages. In his complaint, Paredes alleged that Espino has sold to him Lot No. 62 of the Puerto Princesa Cadastre at P4.00 a square meter; that the deal had been closed by “letter and telegram;” but that actual execution of the deed of sale and payment of the price were deferred to the arrival of Espino at Puerto Princesa, Palawan; that Espino upon arrival had refused to execute the deed of sale although Paredes was able and willing to pay the price; that Espino continued to refuse despite written demands by Paredes; that as a result, Paredes has lost expected profits from a resale of the property. As proof of the sale, Paredes annexed the following letter signed by Espino —

“Dear Mr. Paredes.

. . . please be informed that after consulting with my wife, we both decided to accept your last offer of P4.00 per square meter of the lot which contains 1,826 square meters and on cash basis.

“In order that we can facilitate the transaction of the sale in question, we (Mrs. Espino and I) are going there (Puerto Princesa, Pal.) to be there during the last week of May.”

Paredes also attached both a previous letter from Espino (re the offer) and a telegram from Espino advising Paredes of Espino’s arrival by boat. Espino’s defense was that there was no written contract of sale, and that, therefore, the contract is unenforceable under the Statute of Frauds.

HELD: The contract is enforceable. The Statute of Frauds does not require that the contract itself be in writing. A written note or memorandum signed by the party charged (Espino) is enough to make the oral agreement enforceable. The letters written by Espino together constitute a sufficient memorandum of the transaction; they are signed by Espino, refer to the property sold, give its area, and the purchase price — the essential terms of the contract. A “sufficient memorandum” does not have to be a single instrument — it may be found in two or more documents.

(24) BAR QUESTION

Of what statutes is the term “Statute of Frauds” descriptive? To what kind of contract are these statutes applicable, and in what kind of actions may they be invoked?

ANS.:

- (a) The term “Statute of Frauds” is descriptive of those laws, statutes, or provisions which require certain agreements to be in writing before they can be enforced in a judicial action. The law considers the memory of man unreliable, hence the need for the writing. The statute was designed to prevent fraud and the commission of perjury. (*See Nat. Bank v. Phil. Veg. Oil Co.*, 49 Phil. 857).
- (b) These statutes are applicable only to executory contracts, not to partially or totally executed or performed contracts. (*Facturan v. Sabanal*, 81 Phil. 512).
- (c) These statutes may be invoked in actions for damages for breach of said agreement or for specific performance thereof, and not in any other matter. (*Facturan v. Sabanal*, 81 Phil. 512; *see Lim v. Lim*, 10 Phil. 635).

(25) BAR

In a certain registration proceedings, the applicant *A* testified that he had been in the possession of the land sought to be registered since the year 1912, when *B*, oppositor's predecessor in interest, sold the same to him under a verbal contract for P1,000. The oppositor asked for the striking off of the statement of *A* regarding the alleged verbal contract of sale of the property on the ground that the same cannot be proved under the Statute of Frauds. Is the oppositor's petition tenable? Reason out your answer briefly.

ANS.: If *A*'s possession was because the land had been delivered to him by the seller *B*, then the contract is already executed, at least on *B*'s part, and not merely executory; hence, the Statute of Frauds is not applicable. The verbal contract of sale can thus be proved, and the oppositor's contention is not tenable. (See *Almirol, et al. v. Monserrat*, 46 *Phil.* 67 and *Diana v. Macalibo*, 74 *Phil.* 70).

(26) Rule on Authority of the Agent to Sell Land or Any Interest Therein

Under the Civil Code, "when a sale of a piece of land or any interest therein is through an agent, the authority of the latter shall be in writing; otherwise, the sale shall be void." (*Art. 1874*). Note that the law says "void," not merely unenforceable.

(27) Oral Promise to Put in Writing

An *oral* promise to put in writing an agreement that is covered by the Statute is *itself* unenforceable. (37 *C.J.S.* 745).

(28) The Third Kind of Unenforceable Contract

The third kind of unenforceable contract is one where both parties are incapacitated to give consent.

Example: A contract entered into by two unemancipated minors without parental consent.

(29) New Jurisprudence**Gerardo Cordial v. David Miranda
GR 135492, Dec. 14, 2000**

Unless otherwise provided by law, a contract is obligatory in whatever form it is entered into, provided all the essential requisites are present. When a verbal contract has already been completed, executed or partially consummated, its enforceability will not be barred by the Statute of Frauds, which applies only to an executory agreement.

Art. 1404. Unauthorized contracts are governed by Article 1317 and the principles of agency in Title X of this Book.

COMMENT:**Unauthorized Contracts**

- (a) See comments under *Art. 1317, Civil Code*.
- (b) Ratification cures an *unauthorized* contract. Unless ratified, the contract has no effect. (*Tagaytay Dev. Co. v. Osorio, 69 Phil. 180*).

Art. 1405. Contracts infringing the Statute of Frauds, referred to in No. 2 of Article 1403, are ratified by the failure to object to the presentation of oral evidence to prove the same, or by the acceptance of benefits under them.

COMMENT:**(1) Ratification of Contracts Infringing the Statute of Frauds**

Two ways of ratification of contracts infringing the Statute of Frauds are given here:

- (a) *failure to object to the presentation of oral evidence* (this is deemed a waiver). (*See Domalagan v. Bolifer, 33 Phil. 471*).
- (b) *acceptance of benefits under them* (thus, the statute does

not apply to executed or partially executed or performed contracts). (*Hernandez v. Andal*, 78 Phil. 196).

[NOTE: Partial performance of a contract of sale does not only occur when part of the purchase price is paid. There are other acts of partial performance such as possession, payment of taxes, building of improvements, tender of payment plus surveying of the lots at the buyer's expense. (*Ortega v. Leonardo*, L-11311, May 28, 1958).]

(2) Example of Waiver

Cross-examination of the witnesses testifying orally on the contract amounts to a waiver or to a failure to object. (*Abrenica v. Gonda & De Gracia*, 34 Phil. 739).

Art. 1406. When a contract is enforceable under the Statute of Frauds, and a public document is necessary for its registration in the Registry of Deeds, the parties may avail themselves of the right under Article 1357.

COMMENT:

(1) Right of One Party to Compel the Other to Execute the Needed Instrument

It must be stressed here that the right of one party to have the other execute the public document needed for convenience in registration, is given only when the contract is *both valid and enforceable*. (*See comments under Art. 1357, Civil Code*).

(2) Example

A sale of realty in a private instrument is not valid and enforceable; hence, a public document may be executed so that the sale could be registered. An oral sale of real property is not enforceable; hence, one party cannot compel the other to execute the public document. However, if said oral sale of real property has been ratified, then it is now both valid and enforceable, and a public document may be made so that the sale can be registered.

Art. 1407. In a contract where both parties are incapable of giving consent, express or implied ratification by the parent, or guardian, as the case may be, of one of the contracting parties shall give the contract the same effect as if only one of them were incapacitated.

If ratification is made by the parents or guardians, as the case may be, of both contracting parties, the contract shall be validated from the inception.

COMMENT:

Contract Where Both Parties Are Incapacitated

Example: A and B, both 15 years old, entered into a contract. The contract is unenforceable because both parties cannot give consent. Now if the guardian or parent of A ratifies expressly or impliedly the contract, it becomes voidable, valid unless annulled by the guardian or parent of B. However, if the guardian or parent of B also ratifies, the contract is validated right from the time it was first entered into.

Art. 1408. Unenforceable contracts cannot be assailed by third persons.

COMMENT:

Strangers Cannot Assail Unenforceable Contracts

Just as strangers cannot attack the validity of voidable contracts, so also they cannot attack a contract because of its unenforceability. Indeed, the Statute of Frauds cannot be set up as a defense by strangers to the transaction. (*Ayson v. Court of Appeals*, 97 Phil. 965).

Chapter 9

VOID OR INEXISTENT CONTRACTS (New, except Articles 1411 and 1412.)

INTRODUCTORY COMMENT:

(1) Voidable and Void Contracts Distinguished

<i>VOIDABLE</i>	<i>VOID</i>
(a) may be ratified	(a) cannot be ratified
(b) produces effects 'til annulled	(b) <i>generally</i> , effects are not produced at all
(c) defect is due to incapacity or vitiated consent	(c) the defect here is that <i>ordinarily</i> , public policy is militated against
(d) valid 'til annulled	(d) void from the very beginning so generally, no action is required to set it aside, unless the contract has already been performed
(e) may be cured by prescription	(e) cannot be cured by prescription
(f) defense may be invoked only by the parties (those principally or subsidiarily liable), or their successors in interest and privies	(f) defense may be availed of by anybody, whether he is a party to the contract or not, as long as his interest is directly affected. (<i>Art. 1421, Civil Code</i>).
(g) referred to as <i>relative</i> or <i>conditional nullity</i>	(g) referred to as absolute nullity

(2) Unenforceable and Void Contracts Distinguished

<i>UNENFORCEABLE</i>	<i>VOID</i>
(a) may be ratified	(a) cannot be ratified
(b) there is a contract but it cannot be enforced by a court action	(b) no contract at all
(c) cannot be assailed by third parties	(c) can be assailed by anybody directly affected

Art. 1409. The following contracts are inexistent and void from the beginning:

- (1) Those whose cause, object or purpose is contrary to law, morals, good customs, public order, or public policy;**
- (2) Those which are absolutely simulated or fictitious;**
- (3) Those whose cause or object did not exist at the time of the transaction;**
- (4) Those whose object is outside the commerce of men;**
- (5) Those which contemplate an impossible service;**
- (6) Those where the intention of the parties relative to the principal object of the contract cannot be ascertained;**
- (7) Those expressly prohibited or declared void by law.**

These contracts cannot be ratified. Neither can the right to set up the defense of illegality be waived.

COMMENT:

(1) Enumeration of the Void Contracts

The Article enumerates the various kinds of VOID contracts.

(2) Special Classification

In the case of *Liguez v. Lopez*, 102 Phil. 577, the Supreme Court, thru Mr. Justice J.B.L. Reyes, stated that there are two kinds of VOID contracts:

- (a) The *inexistent* ones (like those where essential formalities are not complied with; *example: a donation of land in a private instrument; this produces no effect whatsoever*).
- (b) The *illegal* or *illicit* ones (like a donation made because of an *immoral* condition, such as illicit sexual intercourse). (Here, in some way, the donation produces some effect in that he who gave the donation cannot get back what he has given.)

With reference to paragraph (1) of Art. 1409 — it has been held that a subdivision may properly stipulate *building restrictions* (such as limiting the construction of buildings to those of the *character of residences*). (*Rafaela V. Trias v. Gregorio Araneta, Inc.*, L-20786, Oct. 30, 1965).

(3) Non-Existing Cause or Object

Paragraph 3 speaks of contracts “whose cause or object did not exist at the time of the transaction.” This is not exactly correct because there can be valid contracts involving future property; *example: sale of future or after-acquired property*.

Thus, Mr. Justice J.B.L. Reyes notes: “Did not exist at the time of the transaction” should be “could not come into existence because the object may legally be a future thing.” (*See Arts. 1347, 1461, Civil Code; Lawyer’s Journal, Jan. 31, 1951*).

Singson v. Babida L-30096, Sept. 27, 1977

Surety bonds should be signed not only by the sureties but also by the principal obligors (the defendants in a case, for example). If not signed by the latter the surety bonds are void, there being no principal obligation (which is, of course, the cause or consideration of such surety bonds).

Rivero v. Court of Appeals
L-37159, Nov. 29, 1977

A contract whereby the seller's signature was obtained thru the fraudulent misrepresentation that what she was signing was a mere mortgage and not a deed of sale is not valid.

(4) Simulated Contracts

- (a) If *absolutely* simulated, the contract is void for utter lack of consent.
- (b) If *relatively* simulated, the hidden or intended contract is generally binding. (*Onglengco v. Ozaeta*, 70 Phil. 43).

Castillo v. Castillo
L-81238, Jan. 22, 1980

If a mother sells to her child, property at a price very much lower than what she had paid for it, only three months before, this is an indication that the sale is fictitious.

Cariño v. CA
GR 47661, Jul. 31, 1987

FACTS: P. Encabo formally applied with the Land Estates Division, Bureau of Lands, to purchase a parcel of land. Thereafter, Encabo, through C. Vicencio, supposedly as "agent," came to an agreement with J. Quesada transferring rights over the lot to the latter, conditioned on approval by Land Tenure Administration (LTA). C. Vicencio's husband (J. Cariño) is a relative of J. Quesada. The transfer of rights by Encabo to Quesada was not put in writing, but payment of the price for the rights transferred was evidenced by receipts on which C. Vicencio signed as a witness. The LTA unaware of the transfer of rights by Encabo to J. Quesada adjudicated the lot in favor of Encabo. The LTA and Encabo signed an agreement to sell. The LTA later came to know about the "transfer" of rights from Encabo to Quesada. It disapproved the same because Quesada was not qualified to acquire the lot since he was already a lot owner. Before LTA's disapproval of

the transfer of Encabo's right to Quesada, the latter took possession of the lot. Quesada also allowed Vicencio to occupy it.

Later, Encabo executed a deed of sale (Exhibit D-1) conveying his rights to Vicencio, subject to LTA's approval. Encabo then wrote the LTA seeking permission to transfer his rights. Thereafter, Encabo and Quesada executed a document where the latter purportedly resold to Encabo the house and rights over the lot. Afterwards, Cariño sought the LTA's approval of the transfer of rights to the lot in question on the basis of the Deed of Sale executed by Encabo. The LTA held that the status *quo* should be maintained. When Cariño refused to give up possession of the lot, Encabo filed an action with the CFI to declare them the owners of the lot. The CFI rendered a decision in favor of Encabo. The Court of Appeals sustained the CFI (now RTC).

HELD: Exhibit D-1 is simulated. The Cariños could not produce the receipts evidencing their alleged payments to the Land Authority. The simulated deed of sale in favor of Cariño was executed to protect the money Quesada invested in the purchase of the rights, which transfer was later disapproved by the LTA. There has been no legal transfer of rights in favor of Cariño because neither the LTA nor the Land Authority has approved or given due course to such transfer of rights. Since no approval or due course has been given by the LTA or LA, the document is unenforceable against the LTA.

(5) Contracts Expressly Prohibited by the Law

- (a) In the case of *Medina v. Coll. of Int. Rev., et al., L-15113, Jan. 28, 1961*, petitioner, a forest concessionaire, SOLD logs produced in his concession to his WIFE, who was engaged in business as a lumber dealer. The wife in turn sold the logs to others thru her husband's agent. *Issue:* Which sales are taxable — those to the wife, or those in favor of the strangers?

HELD: The taxable sales are those made by the wife to strangers thru her husband's agent because the sales made

by her husband to her are VOID and expressly prohibited by the law. (*See Art. 1490, Civil Code*).

- (b) In the case of *Jose C. Aquino, et al. v. Pilar Chaves Conato and the Workmen's Compensation Commission, L-18333, Dec. 29, 1965*, it was held that under Sec. 7 of Act 3428, as amended (The Workmen's Compensation Law), any contract, devise of any sort, or waiver intended to exempt the employer from all or part of the liability created by said Act is null and void.
- (c) In the case of *Ras v. Sua, L-23302, Sept. 25, 1968*, it was ruled that under RA 477, if the applicant for public land from the NAFCO (Nat. Abaca and Other Fibers Corporation) makes a transfer of his rights BEFORE the award or the signing of the contract of sale, said transfer is *null and void*, and disqualifies such applicant from further acquiring any land from the NAFCO. (*See Sec. 8, 2nd paragraph, RA 477*).

**De la Cruz v. Better Living, Inc.
L-26936, Aug. 19, 1977**

Influence peddling is prohibited by the Anti-Graft Law, but the law does not have any retroactive effect.

**Insular Life Assurance Co.,
Ltd. v. Ebrado
80 SCRA 181**

A common-law spouse of a husband, even if designated as the insurance beneficiary of the latter, cannot receive said insurance proceeds. Only preponderance of evidence is required to prove the adultery or concubinage committed. No criminal conviction for either crime is needed. If stipulated by the parties, the adultery or concubinage may be regarded as a judicial admission.

**Tolentino v. Judge Edgardo L. Paras
GR 43095, May 30, 1983**

If a marriage is bigamous and *void* from the beginning, there is no need to have a judicial decree to declare its invalidity.

**COMELEC, etc. v. Judge Ma. Luisa Quijano-Padilla
RTC of QC Br. 215 & Photokina
Marketing Corporation
GR 151992, Sep. 18, 2002**

FACTS: Photokina's bid is beyond the amount appropriated by Congress for the VRIS Project. VRIS stands for voters' Registration and Identification System. The VRIS Project envisions a computerized database system for the May 2004 Elections. The idea is to have a national registration of voters whereby each registrant's fingerprints will be digitally entered into the system and upon completion of registration, compared and matched with other entries to eliminate double entries. A tamper-proof and counterfeit-resistant voter's identification card will then be issued to each registrant as a visual reward of the registration.

ISSUE: Can Photokina, although the winning bidder, compel the COMELEC to formalize the contract with it notwithstanding that its bid exceeds the amount appropriated by Congress for the project?

HELD: No. The proposed contract is not binding upon the COMELEC and is considered void. Verily, the contract is inexistent and void *ab initio*. (Art. 1409, Civil Code).

This is to say that the proposed contract is without force and effect from the very beginning or from its inception, as if it had never been entered into, and, hence, cannot be validated either by lapse of time or ratification. (*See Manila Lodge v. CA, 73 SCRA 162 [1976]*). (*See also Tongoy v. CA, 123 SCRA 99 [1983]*).

Enshrined in the 1987 Philippine Constitution is the mandate that "no money shall be paid out of the Treasury except in pursuance of an appropriation made by law." (Sec. 29[1], The 1987 Phil. Const.). Thus, in the execution of government contracts, the precise import of this constitutional restriction is to require the various agencies to limit their expenditures within the appropriations made by law for each fiscal year.

Complementary to the abovesited constitutional injunction are pertinent provisions of law and administrative

issuances designed to effectuate said mandate in a detailed manner Secs. 46 and 47, respectively, Chapter 8, Subtitle B, Title 1, Book V of EO 292, otherwise known as the “Administrative Code of 1987.” Sec. 46 provides that “[n]o contract involving the expenditure of public funds shall be entered into unless there is an appropriation therefore, the unexpended balance of which, free of other obligations, is sufficient to cover the proposed expenditures.” Sec. 47 provides that “no contract involving the expenditure of public funds by any government agency shall be entered into or authorized unless the proper accounting official of the agency concerned shall have certified to the officer entering into the obligation that funds have been duly appropriated for the purpose and that the amount necessary to cover the proposed contract for the current calendar year is available for expenditure on account therefore subject to verification by the auditor concerned.”

Quite evident from the tenor of the language of the law is that the existence of appropriations and the availability of funds are indispensable prerequisites to or conditions *sine qua non* For the execution of government contracts. The obvious intent is to impose such conditions as *a priori* requisites to the validity of the proposed contract. Using this as premise, the Supreme Court said it “cannot accede to Photokina’s contention that there is already a perfected contract.”

Extant on the record is the fact that the VRIS Project was awarded to Photokina on account of its bid in the amount of P6.588 billion. However, under RA 8760 (*General Appropriations Act, FY 2000*), the only fund appropriated for the project was P1 billion and under the Certification of Available Funds (CAF) only P1.2 billion was available. Clearly, the amount appropriated is insufficient to cover the cost of the entire VRIS Project. There is no way the COMELEC could enter into a contract with Photokina whose accepted bid was way beyond the amount appropriated by law for the project. The objection of then COMELEC chair Harriet O. Demetriou to the implementation of the VRIS Project, ardently carried on by her successor, Chair Alfredo L. Benipayo, are, therefore, in order.

Be this as it may the Notice of Award, being in the eyes of the law null and void, there is authority that in the absence of any reservation in the contract, public authorities cannot, without incurring liability for breach of contract, after a bid has been accepted and the contract awarded, rescind such award and contract, *except* for some cause which, is the eye of the law, renders it void or voidable. (64 *Am Jur 2d Sec. 79* citing *United States v. Corliss Steam Engine Co.*, 91 U.S. 321, 23 L Ed 397; and *State ex rel. Robert Mitchell Furniture Co. v. Toole*, 26 Monte 22, 66 P496).

Petitioners COMELEC Commissioners are, therefore, justified in refusing to formalize the contract with Photokina. Prudence dictated them not to enter into a contract not backed up by sufficient appropriation and available funds. Definitely, to act otherwise would be a futile exercise for the contract would inevitably suffer the vice of nullity. After all, the contracting prerogative of public officers is circumscribed with a heavy burden of responsibility. They must exercise utmost caution and observe the law in order to protect the public from unjust and inequitable government contracts. In sum, the case at bar provides occasion to stress that with respect to government contracts, statutes take precedence over the public officers' freedom to contract.

(6) Sale to a Concubine of Conjugal Abode Is Considered VOID

Mercedes Canullas v. Hon. Willelmo Fortun
L-57499, Jun. 22, 1984

If a husband abandons his family and later sells the conjugal home to his concubine, the sale is VOID because it is contrary to good morals and public policy.

(7) Contracts Prohibited Under the Constitution

Query: What are examples of the contracts contemplated by the charter? May a member of Congress borrow money from the Philippine National Bank or the Rehabilitation Finance Corporation (now the Development Bank of the Philippines)?

ANSWER:

- (a) The framers of the Constitution could not have intended to deprive a member of Congress of the facilities and services of the Manila Hotel, the Light Railway Transit (LRT), etc. Yet when a Senator or Representative hires a room in the Manila Hotel, rides in an aircraft of the Philippine Air Force, or deposits money in the Philippine National Bank, a contract is made between him and the government entity concerned, and such a contract is obviously NOT within the purview of the prohibition in question. The prohibited contracts are those that involve a financial investment or business of which the member of Congress expects to derive gain; for instance, a contract to construct a fly-over bridge or build a road, a contract to furnish materials or supplies, or a contract to buy, sell, or lease real or personal property. Here, a member of Congress may be tempted to misuse his official prestige and influence.
- (b) There is no doubt that a member of Congress may deposit money with the Philippine National Bank although he may earn interest. He does so because to him, the PNB may be the safest place to keep his money. If instead of depositing (lending) money, he borrows money, with sufficient guarantees, he in effect makes it possible for the Bank itself to profit from its investment. It is clear therefore that to obtain the loan could not have been intended by the drafters of the Constitution as a prohibited transaction. (*See Opinion of the Secretary of Justice, Opinion No. 49, series of 1948*).

(8) Some Characteristics of Void Contracts

- (a) The right to set up the defense of illegality cannot be waived (*Art. 1409, Civil Code*), and may be considered on appeal even if not raised in the trial court. (*Garrido v. Perez Cardenas, 60 Phil. 964*).
- (b) The action or defense for their declaration as inexistent does not prescribe. (*Art. 1410, Civil Code*).
- (c) The defense of illegality of contracts is *not* available to third persons whose interests are not directly affected. (*Art. 1421, Civil Code*).

- (d) Cannot give rise to a contract; thus “a contract which is the direct result of a previous illegal contract is also void and inexistent.” (*Art. 1422, Civil Code*).
- (e) Generally produces no effect.
- (f) Generally, no action to declare them void is needed, since they are inexistent from the very beginning.
- (g) They cannot be ratified. (*Art. 1409, Civil Code*).

(NOTE: If a new and valid contract is entered into about the same thing, the new contract is of course binding, but this is not *technically* the “ratification” referred to in the law. Thus, a donation of land in a *private* instrument is void, but if a month later the same donation is made in a public instrument, the donation becomes valid, but this time, the new contract becomes valid and effective, not from the date of the original agreement, but from the date of the new agreement, for *technically* there has been no *ratification*.)

[NOTE: In the case of *Garrido v. Perez Cardenas*, 60 *Phil.* 964, it was held that if a contract is entered into and the obligation is assumed by the debtor in order to prevent the prosecution of the debtor for a criminal offense, the same is void for being contrary to law and public order. But if the purpose be different, there is a chance that the contract would be valid. In the *Garrido* case, a certain Atty. Camus was charged by Garrido with swindling him in the amount of P2,000. The fiscal (now prosecutor) advised Camus to settle the matter with Garrido, otherwise he would prosecute him (Camus). So Camus guaranteed payment of the amount with Atty. Perez Cardenas, his employer, as co-signer *in solidum*. Perez Cardenas *never* dealt with Garrido. It was Camus who asked his employer Perez Cardenas to sign the note. When asked why he signed the note, Cardenas testified that he did not even know that a complaint for swindling had been filed against Camus in the fiscal’s (prosecutor’s) office and was pending; that he was merely advised by Camus that he had “a certain obligation in favor of Mr. Garrido and that he (Camus) wanted to have an extension of time within which to pay it,” and that

he signed because he thought he could thereby help the young man, who was then a lawyer, develop himself into a better man. It was held that *not* being contrary to law, customs, etc. the note was *valid* insofar as Cardenas was concerned. The fact that subsequently the criminal case was withdrawn did *not* alter the situation materially.]

[NOTE: In *Mactal v. Melegrito*, L-16114, March 24, 1961, the court ruled that a promissory note to pay money illegally converted by an agent (a note signed so that the estafa case against the plaintiff would be withdrawn) is VALID because the real consideration for the note was the pre-existing debt. The dismissal of the *estafa* case was *not* the consideration; it merely furnished the *occasion* for the execution of the *note*.]

Bobis v. Prov. Sheriff of Camarines Norte
GR 29838, Mar. 18, 1983

If a judgment debtor conveys property to another *before* levy is made on said property, anybody who buys the same at the execution sale acquires *no right* over the property.

Pilipinas Shell Petroleum Corp. v.
De la Rosa and the Workmen's
Compensation Commission
L-41301, Dec. 15, 1986

The Workmen's Compensation Act (Sec. 7, Act 3427) condemns such contracts as "Document of Full Satisfaction," or "Release," or "Release of Claim." Said law declares null and void any contract "of any sort intended to exempt the employer from all or part of the liability created by [said] Act."

(9) Sale of Conjugal Properties

The sale of conjugal properties cannot be made by the surviving spouse without the formalities established for the sale of property of deceased persons, and such sale is VOID as to the share of the *deceased spouse*. (*Ocampo v. Potenciano*,

L-2263, May 30, 1951 and Talag v. Tankengco, 92 Phil. 1066). The vendee becomes a *trustee* of the *share* of the latter for the benefit of his heirs, the *cestui que trustent*. (See Art. 1456, *Civil Code and Cuison, et al. v. Fernandez, et al., L-11764, Jan. 31, 1959*).

(10) Who May Attack Contracts Alleged to Be Fictitious or Void

**Gorospe v. Santos
L-30079, Jan. 30, 1976**

FACTS: A debtor who had mortgaged his land was not able to pay the debt, so the mortgage was extrajudicially foreclosed. He then sold his *right to redeem* to a third person, who then proceeded to redeem the property. The creditor-mortgagee who had purchased the property at the foreclosure questioned this redemption by the debtor's assignee on the ground that the transfer of the right to redeem was simulated or fictitious, but he could not present proof to overcome the public instrument respecting the sale of assignment of the right to redeem. *Issue:* Does the redemption remain valid?

HELD: Yes, firstly because he was not able to overcome the probative value of the public documents, and secondly, because whether or not the assignment was fictitious or fraudulent, he, the mortgagee, cannot be said to have been damaged.

(11) The Case of Abelardo Lim

**Abelardo Lim & Esmadito Gunnaban v.
CA & Donato H. Gonzales
GR 125817, Jan. 16, 2002**

ISSUE: When a passenger jeepney covered by a certificate of public convenience (CPC) is sold to another who continues to operate it under the same CPC under the so-called "*kabit*" system, and in the course thereof the vehicle meets an accident thru the fault of another vehicle, may the new owner sue for damages against the erring vehicle?

Otherwise stated, does the new owner have any legal personality to bring the action, or is he the real party-in-interest in the suit, despite the fact that he is not the registered owner under the CPC?

HELD: Yes. In the present case, it is at once apparent that the evil sought to be prevented in enjoining the *kabit* system does not exist. Three (3) reasons are adduced, namely.

First, neither of the parties to the pernicious *kabit* system is being held liable for damages.

Second, the case arose from the negligence of another vehicle in using the public road to whom no representation, or misrepresentation, as regards ownership and operation of the passenger jeepney was made and to whom no such representation, or misrepresentation, was necessary. Thus, it cannot be said that private respondent and the registered owner of the jeepney were estopped for leading the public to believe that the jeepney belonged to the registered owner.

Third, the riding public was not bothered nor inconvenienced at the very least by the illegal arrangement. On the contrary, it was private respondent himself who had been wronged and was seeking compensation for the damage done to him. Certainly, it would be the height of inequity to deny him his right.

In light of the foregoing, it is evident that private respondent has the right to proceed against petitioners for the damage caused on his passenger jeepney as well as on his business. Any effort then to frustrate his claim of damages by the ingenuity with which petitioners framed the issue should be discouraged, if not repelled.

[NOTE: The *kabit* system is an arrangement whereby a person who has been granted a CPC allows other persons who own motor vehicles to operate them under his license, sometimes for a fee or percentage of the earnings. (*Lita Enterprises, Inc. v. Second Civil Cases Division, IAC, GR 64693, Apr. 27 1984; Baliwag Transit, Inc. v. CA, GR 57493, January 7, 1987; and Teja Marketing v. IAC, GR 65510, March 9, 1987*). Although the parties to such an agreement are not outrightly penalized by law, the *kabit* system is invariably recognized as being contrary

to public policy and, therefore, void and inexistent under Art. 1409. (*Lim & Gunnaban v. CA & Gonzales, supra*).]

Art. 1410. The action or defense for the declaration of the inexistence of a contract does not prescribe.

COMMENT:

(1) Action for Declaration of Inexistence of the Contract Does Not Prescribe

This Article is a new provision of the Civil Code. If a contract is null and void, the action to declare it null and void or to declare its non-existence is imprescriptible. On the other hand, the illegality of the contract can always be set up as a defense, despite the passage of time. Thus, in the case of *Angeles, et al. v. Court of Appeals, 102 Phil. 1006*, it was held by the Supreme Court that the sale of a homestead patent is contrary to law, and void; and therefore, the action or defense for the declaration of its nullity and inexistence does not prescribe. Mere lapse of time cannot give effect to contracts that are null and void.

**Caram, Jr. v. Laureta
L-28740, Feb. 24, 1981**

One who buys land in bad faith (for the buyer should have known that its possessor had already bought the same) enters into what is known as a VOID, not merely voidable, contract. Therefore, any action or defense for the declaration of the existence of the contract does not prescribe. (*Art. 1410, Civil Code*). The mere fact that Art. 1544 does not declare void a deed of sale registered in bad faith does *not* mean that said contract is *not* void.

**Buenaventura v. CA
GR 50837, Dec. 28, 1992**

In case of fraud in the transfer of the property as alleged in petitioner's complaint, Art. 1410 of the Civil Code on imprescriptibility of actions cannot be deemed applicable.

Verily, the principle on prescription of actions is designed to cover situations where there have been a series of transfers

to innocent purchasers for value. To set aside these transactions only to accommodate a party who has slept on his rights is anathema to good order. Independently of the principle of prescription of actions working against petitioner, the *doctrine of laches* may further be counted against them, which latter tenet finds application even to imprescriptible actions. Thus, while it is true that, technically, the action to annul a void or inexistent contract does not prescribe; it may, nonetheless, be barred by laches.

Heirs of Ingjugtiro v. Sps. Casals
GR 134718, Aug. 20, 2001

The positive mandate of Art. 1410 conferring imprescriptibly to actions for declaration of the inexistence of a contract should preempt and prevail over all abstract arguments based only on equity.

Certainly, laches cannot be set up to resist the enforcement of an imprescriptible legal right, and petitioners can validly vindicate their inheritance despite the lapse of time.

(2) Query on Whether Void Contract Still Has to Be Declared Void

The question may be asked: If a void contract is void from the very beginning, what is the use of its being declared inexistent?

Strictly speaking, there is no use. But for purposes of convenience, or to avoid taking the law into our own hands, there is nothing wrong in having a void contract declared really void. *For example: A sells B the Jones Bridge and B gives A the price. Of course, this contract is null and void, but suppose A refuses to return to B the price, stating that there is nothing wrong with the contract, what should B do? B should file an action in court to declare the inexistence of the contract. This right of B to bring the action does not prescribe. Indeed, the defect in this kind of contract cannot be cured by prescription or by ratification. (See Eugenio v. Perdido, 97 Phil. 41 and Dingle v. Guillermo, [C.A.] 48 O.G. 4410.)*

Tolentino v. Paras
GR 43095, May 30, 1983

A void bigamous marriage, being already void, does NOT have to be declared void by the courts.

Sps. Narciso Rongavilla & Dolores
Rongavilla v. CA, et al.
GR 83974, Aug. 17, 1998

The defect of inexistence of a contract is permanent and incurable; hence, it cannot be cured either by ratification or by prescription. There is no need of an action to set aside a void or in-existent contract; in fact such action cannot logically exist.

An action, however, to declare the non-existence of the contract can be maintained; and in the same action, the plaintiff may recover what he has given by virtue of the contract.

Art. 1411. When the nullity proceeds from the illegality of the cause or object of the contract, and the act constitutes a criminal offense, both parties being in *pari delicto*, they shall have no action against each other, and both shall be prosecuted. Moreover, the provisions of the Penal Code relative to the disposal of effects or instruments of a crime shall be applicable to the things or the price of the contract.

This rule shall be applicable when only one of the parties is guilty; but the innocent one may claim what he has given, and shall not be bound to comply with his promise.

COMMENT:

The ‘Pari Delicto’ Rule Refuses Legal Remedy to Either Party to an Illegal Agreement and Leaves Them Where They Were

The *raison d’être*: Ours are courts of both law and equity — they compel fair dealing and do not abet clever attempts to escape just obligations. (*Abacus Securities Corp. v. Ampil*, 483 SCRA 315 [2006]).

Where the act involved constitutes a criminal offense, *i.e.*, forging a person's signature punishable under Sec. 4, Title IV of the RPC, the applicable provision is Art. 1411 of the New Civil Code. In *Ramirez v. Ramirez* (485 SCRA 92 [2006]), the Supreme Court held that object and cause, are two separate elements of a donation and the illegality of either element gives rise to the application of the doctrine of *pari delicto*.

Art. 1412. If the act in which the unlawful or forbidden cause consists does not constitute a criminal offense, the following rules shall be observed:

(1) When the fault is on the part of both contracting parties, neither may recover what he has given by virtue of the contract, or demand the performance of the other's undertaking;

(2) When only one of the contracting parties is at fault, he cannot recover what he has given by reason of the contract, or ask for the fulfillment of what has been promised him. The other, who is not at fault, may demand the return of what he has given without any obligation to comply with his promise.

COMMENT:

(1) Two Kinds of Illegal Contracts

There are two kinds of illegal contracts:

- (a) those where there is a *criminal offense*;
- (b) those where there is *no* criminal offense.

(2) Illegal and Criminal Contracts

Those contracts where there is a CRIMINAL OFFENSE may be of two kinds:

- (a) those where *both parties* are guilty (*in pari delicto*);
- (b) those where only one is *guilty* and the other is *innocent*.

NOTE:

- (a) Those where BOTH are GUILTY:

- 1) *Example*: both entered into a contract for smuggling or importation of contraband. (*Iribar v. Millat*, 5 Phil. 362).
- 2) *Effects*:
 - a) Since they are *in pari delicto*, they shall have *no* action against each other.
 - b) Both shall be prosecuted.
 - c) The effects or the instruments of the crime (things or price of the contract) shall be confiscated in favor of government.

Packaging Products Corp. v. NLRC
GR 50383, Jul. 23, 1987

FACTS: BE was employed by PPC since 1959. While holding the position of Group Account Executive in 1970, the Corporation's Board Chairman assigned him to handle and develop the account of LTI, which requires 7 million corrugated shipping boxes a year. On account of the profitability of the assignment, BE demanded for and was given an incentive in the form of 7% commission, which was different and distinct from the regular one-half per cent (1/2%) of the aggregate value of the actual monthly sales to LTI. The arrangement for paying this commission was that the checks were made payable to BE after invoice (and before payment) during the first week of every succeeding month with the fictitious PRC appearing in the checks as payee. The use of the fictitious name was allegedly to cover-up the rather anomalous situation where a mere salesman of the corporation could appear to be earning more than its officers or executives.

BE served the account of LTI until PPC took it away from him in 1977. He therefore charged PPC guilty of diminution of the benefits and claimed that PPC should pay him the com-

missions due him from LTI, Inc. PPC, on the other hand, contends, that the 7% commission constituted the commission rebates given by PPC to certain employees of LTI, and admitted that the name of PRC was fictitious, but maintains that the name was used merely to facilitate the issuance of vouchers and checks corresponding to the 7% commission rebates.

ISSUE: Is BE entitled to unpaid commissions equivalent to 7% of total sales he effected, aside from his regular 1/2% commission, based on the aggregate value of the actual monthly sales to LTI?

HELD: The Supreme Court cannot give positive relief to either BE or PPC because it is asked to interpret and enforce an illegal and immoral arrangement. Kickback arrangement in the purchase of materials and other needs of manufacturers are void. Both BE and PPC are *in pari delicto*. Neither one may expect positive relief from courts of justice in interpreting their contract. The courts will leave them as they were at the time the case was filed.

The subject matter of the agreement sought to be enforced being illegal and immoral, the resolution of the NLRC ordering the PPC to pay BE unpaid commissions in the amount of P272,830, plus legal interest is declared null and void.

- (b) Those where ONLY ONE is GUILTY (or where, even if both are guilty, they are *not equally guilty*, therefore, “not *in pari delicto*” — “not in equal guilt”):
 - 1) *Examples:* X sold government property to Y, who was in good faith; or where a person of age gave a donation to a minor for the purpose of illicit sexual intercourse. (*See Liguez v. Lopez, 102 Phil. 577*).
 - 2) *Effects:*
 - a) The guilty party will be prosecuted.

- b) The instrument of the crime (or object of the contract) will be confiscated (as in the case of government property illegally sold).
- c) The innocent one may claim what he has given (like the price he paid for the government property); or if he has not yet given anything, he shall NOT be bound to comply with his promise.

[NOTE: Even if a contract involves a crime, still if a cause of action can be established *without* referring to the illegal act or motive, relief can be granted by the courts. (*Perez v. Herranz*, 7 Phil. 693).]

Perez v. Herranz
7 Phil. 693

FACTS: Perez, a Filipino, and Herranz, a Spaniard, wanted to buy a steamer. So Perez contributed 1/6 of the price, and Herranz contributed 5/6. But because Herranz, being an alien, could not buy a Philippine steamer, both agreed that the purchase would be in the name of Perez alone. So, a false affidavit was made, and they got the steamer. The false affidavit was of course illegal. When the steamer was given, Herranz took possession of it, and when Perez wanted to get it on the ground that it was registered in his name, Herranz refused. Hence, this action for recovery.

HELD: Ordinarily in a criminal and illegal contract as this, the parties should be left as they are by the court, each having no action against the other. But in this case, even without referring to the illegal act, a proper cause of action could be made out. Perez could present a *prima facie* case in his favor by presenting the deed of sale; Herranz could allege that it had been agreed that *co-ownership* was to exist between them, and both allegations can be given *even without* referring to the illegal affidavit or purpose. Thus, inasmuch as co-ownership was duly proved, Perez and Herranz were declared co-owners in proportion to their respective contributions to the price: Perez was declared owner of 1/6, Herranz, of 5/6.

[NOTE: This was a civil case. No criminal action was instituted by the government.]

(3) Illegal But Not Criminal Contracts

Those contracts which are unlawful or forbidden BUT where there is NO *criminal offense* may be of two kinds:

- (a) those where both are *guilty*.
- (b) those where only one is guilty or at fault.

NOTE:

- (a) Those where *both are guilty*.
 - 1) *Example:* A Filipino sold land to a Chinese after the effective date of the Constitution. (*Planas v. Gawhok*, [C.A.] 50 O.G. 3124, Jul. 1954 and *Cabauatan v. Uy Hoo*, 88 Phil. 103).
 - 2) *Effect:* Neither may recover what he has given by virtue of the contract or demand the performance of the other's undertaking. (*Art. 1412, No. 1*). (Thus, in the example given, the Filipino vendor of his land was not allowed to recover the land illegally sold; neither can the Chinese recover the money paid, for the law will leave them as they are, since they are *in pari delicto*). (See *Planas v. Gawhok*, [C.A.] 50 O.G. 3124, *supra* and *Cabauatan v. Uy Hoo*, *supra*.)

If a Filipino sells his land to a Chinese citizen, but the latter sells the land to a Filipino, as a result of which a new Torrens Transfer Certificate of Title is issued, the validity of the title can no longer be questioned. (*Natividad Herrera, et al. v. Luy Kim Guan, et al.*, L-17043, Jan. 13, 1961).

Philippine Banking Corp. v. Lui She
L-17587, Sept. 12, 1967

The "*pari delicto*" rule does not apply if in a transfer to an alien of Philippine land, the government takes no steps to escheat or to revert the property to the State. If the alien continues to hold on to the land, there would be a continuing violation of the Constitution. Hence, the Filipino assignor should be allowed to get back the property.

De Raquiza v. Castellvi
77 SCRA 88

A party who has voluntarily entered into an illegal and void compromise agreement cannot withdraw or render ineffective, acts already done in connection with their part of the unlawful bargain.

Teja Marketing, et al. v. Nale and IAC
GR 65510, Mar. 9, 1987

FACTS: A purchased a motorcycle with side-car from B to engage in the transportation business. For this purpose, the trimobile was attached to B's transportation line, or franchise, so much so that in the registration certificate B appears to be the owner of the unit. A paid a downpayment of P1,700 with a promise that he would pay B the balance within sixty days. They agreed that B would undertake the yearly registration of the unit with the Land Transportation Company. Eventually, B sued A to recover the unpaid balance. The City Court where the action was originally filed as well as the Court of First Instance (now Regional Trial Court) to which it was appealed ordered A to pay the unpaid balance, and dismissed his counterclaim. The Court of Appeals, however, declared the agreement void, and the parties being *in pari delicto*, neither of them may bring an action against the other to enforce their illegal contract. B assailed the Court of Appeal's decision. The Supreme Court sustained the Court of Appeals and dismissed B's petition.

HELD: Although not outrightly penalized as a criminal offense, the "*kabit* system" is recognized as contrary to public policy and, therefore, void and inexistent. The court will not aid either party to enforce an illegal contract. It will leave them both where it finds them. It would, therefore, be error to accord the parties relief from their predicament. Art. 1412 denies them such aid.

The "*kabit* system" is an arrangement whereby a person who has been granted a certificate of public convenience allows another person who owns motor vehicles

to operate under such franchise for a fee. A certificate of public convenience is a special privilege conferred by the government. Abuse of this privilege by the grantees cannot be countenanced. The “*kabit* system” has been one of the root causes of the prevalence of graft and corruption in government transportation offices.

- (b) Those where only one is guilty or at fault (or where one party is less guilty than the other, hence they are not *in pari delicto*).
 - 1) *Example*: A husband and his wife executed a void contract dividing their conjugal properties, as a result of which the wife was given a certain parcel of land. A certain Bough, who wanted to get the land, lied to the wife and told her falsely that her husband was in town and was going to contest the deed of property separation, in an attempt to induce her to *transfer* the land to him (Bough), so that the husband could *not* get hold of the properties. So, the wife agreed to fictitiously transfer the land to him. Later, Bough brought this action to recover the land and presented as proof the deed of sale to him. The wife, on the other hand, asked for the declaration of the sale as null and void.

HELD: Although the wife was in *delicto*, she was not *in pari delicto* with Bough who, by fraud, induced her to enter into an agreement that was against public policy. Therefore, Bough cannot get the land, and the wife will retain possession of the same. (*Bough v. Cantiveros*, 40 *Phil.* 209).

- 2) *Effects*:
 - a) The guilty party cannot recover what he has given by reason of the contract, or ask for the fulfillment of what had been promised him. (Thus, in the example given, Bough was not allowed to get the land.) (*Bough v. Cantiveros*, 40 *Phil.* 209).
 - b) The party *not* at fault may demand the return of what he has given, without any obligation to comply with his promise. (*Art. 1412, No. 2*).

**Land Ownership by Americans
After the Expiration of the Laurel-
Langley Agreement on Jul. 3, 1974**

On August 17, 1972, the Supreme Court in the case of *Republic v. William H. Quasha* ruled that the “parity rights” amendment to the 1935 Constitution did not grant American citizens and entities the right to *acquire and own private lands* except in cases of hereditary succession. Under the 1973 Constitution, the Philippine Government had the right from July 4, 1974, to take positive steps to acquire these lands from their American holders in view of Art. XVII, Sec. 2, which states that “titles to private lands acquired by such persons. . . *shall be valid as against private persons only*” (thus, not valid as against the State; thus also, the State can order the reversion to the State of said lands). In May, 1974, President Ferdinand Marcos announced the policy of the Government to refrain until May 28, 1975 from taking any action on the rights of American individuals or entities (including religious corporations and associations) with American equity participation beyond 40%. (NOTE: American entities are still allowed to own said lands if their equity participation or share is only up to 40%.) May 27, 1975 was the last day, therefore, of said grace period. Certain companies, however, merely submitted concrete proposals for divestment (instead of immediately effecting divestment of their holdings). These proposals are now being evaluated by the Government as to their good faith, reasonableness, and compliance with Philippine laws and regulations. Submission of said proposals, coupled with eventual actual transfer to Filipinos within a reasonable period, is to be considered sufficient compliance with the terms of the grace period, according to President Marcos. Said “reasonable period of time” also applies to American citizens, who, in good faith had acquired lands in the Philippines not exceeding five thousand (5,000) square meters for a family dwelling and who have taken sufficient action to transfer ownership over such lands to qualified persons or entities. (*See Daily Expresss, May 29, 1975*).

**Mass v. Director of Lands
80 SCRA 269**

While aliens were generally not allowed to acquire lands under the 1935 Constitution, U.S. citizens could generally do so,

and their proprietary rights were not impaired by the proclamation of Philippine Independence on July 4, 1946.

Avila v. CA
GR 45255, Nov. 14, 1986

FACTS: A parcel of land which had been adjudicated to *X* by the Cadastral Court was offered for sale at public auction on account of realty tax delinquency. *Y*, a public school teacher, took part in and won the bidding. Despite the provision of Sec. 579 of the Revised Administrative Code prohibiting public school teachers from buying delinquent properties, nobody, not even the government questioned her participation in said auction sale. After the redemption period, the provincial treasurer executed in *Y*'s favor the final deed of sale. Seven years later, the Original Certificate of Title covering said land was issued in favor of *X*. *Y* sought to review the decree. The Cadastral Court set aside the decree and ordered that the land be adjudicated to *Y*.

HELD: *Y*'s purchase is prohibited under Sec. 579 of the Revised Administrative Code. The sale to her was void. A void contract is inexistent from the beginning. It cannot be ratified. Its illegality cannot be waived. Being party to an illegal transaction, *Y* cannot recover what she has given by reason of the contract or ask for the fulfillment of what has been promised her.

(4) The Pari Delicto Doctrine

- (a) If the two parties to a contract are *in pari delicto*, the doctrine applies even to the spouse of one of them, who although not a signatory to the contract, has sufficiently manifested by affirmative acts her unequivocal concurrence to the contract in controversy. (*See Montederamos v. Ynonoy*, 56 Phil. 457 and *La Urbana v. Villazor*, 59 Phil. 644). If the spouses benefit from the transaction, the acceptance of said benefits raises a strong presumption of knowledge and consent. (*Inco, et al. v. Enriquez*, L-13367, Feb. 29, 1960).
- (b) The doctrine does *not* apply to fictitious or absolutely simulated contracts (*Gonzales v. Trinidad*, 67 Phil. 682),

since these contracts are inexistent (*See Vasquez v. Porta*, 52 O.G. 7615); not to a contract where one party, a minor, is much less guilty than another, who is of age (*Liguez v. Lopez*, 102 Phil. 577); nor to a case where the government is involved for the government is not estopped by the neglect of its officers. (*Central Azucarera de Tarlac v. Collector*, L-11002, Sept. 30, 1958); nor finally to a contract of sale, where on account of a breach of warranty due to a double sale of the same property, damages are suffered — in a case like this the governing articles would be Arts. 1495, 1547, and 1555 on the law of Sales. (*Diosdado Sta. Romana v. Carlos Imperio, et al.*, L-17280, Dec. 29, 1965).

- (c) The doctrine does *not* apply where a superior public policy intervenes. Thus, even if a homestead owner sells it within the *prohibited period* and with presumed knowledge that it is illegal, still the owner or his heir may sue for its recovery, for the purpose of the law is to grant land to said owner or his heir. (*See De los Santos v. Roman Catholic Church*, 94 Phil. 405 and *Angeles v. Court of Appeals, et al.*, L-11024, Jan. 31, 1958).

[NOTE: While the doctrine does *not* apply to the sale of the homestead, it *applies* to the loss of the products received by the buyer and the value of the necessary improvements made by him on the land. Thus, since both the homesteader and the buyer are in bad faith, the claim of the heirs of the homesteader for the products of the land and that of the buyer for the expenses in the construction of the dike, should be denied. (*Angeles v. Court of Appeals, et al.*, L-11024, Jan. 31, 1958). Moreover, what the homesteader or his heirs must return is *not* the increased value of the property, but only the purchase price paid by the buyer. (*Santander, et al. v. Villanueva and Asuncion*, L-6184, Feb. 28, 1958).] This ruling on the repurchase price if made is also applicable to the sale of the homestead AFTER the 5-year period but with the legal right of redemption would, however, appear to be *unjust* if a homesteader, to obtain money, deliberately sells his land to a reluctant purchaser (who nonetheless buys the same on the strength of a written guarantee on the part of the homesteader *not* to repurchase the same). In a case like this, there would be FRAUD on the

part of said homesteader. Indeed, the Court's ruling would encourage the propagation of a "racket" by homesteader who make it a practice to sell, and redeem, and later sell and redeem again, etc. (taking advantage as they do of the rapid increase of land values). While the purpose of the law is indeed to protect the homesteaders, there are also instances when it is AGAINST them that sincere purchasers should be protected.]

- (d) The "*pari delicto*" rule does *not* apply in case of void contracts which are simulated to circumvent a law. For instance, a donation between spouses is generally void under Art. 133 of the Civil Code. And it has been ruled that in such a case, the property can be reclaimed at anytime by the donor or his heirs or by any person prejudiced thereby. To apply the "*pari delicto*" rule in such a case would be to sanction a circumvention of the prohibition. (*Rodriguez v. Rodriguez*, L-23002, Jul. 31, 1967).

(5) Some Questions on Gambling

- (a) What does the law provide regarding gambling losses and gains?

ANS.: "No action can be maintained by the winner for the collection of what he has won in a game of chance. But any loser in a game of chance may recover his loss from the winner, with legal interest from the time he paid the amount lost, and subsidiarily from the operator or manager of the gambling house." (*Art. 2014, Civil Code*).

- (b) Suppose in gambling there was cheating or deceit, what should be done?

ANS.: "If cheating or deceit is committed by the winner, he, and subsidiarily, the operator or manager of the gambling house shall pay by way of exemplary damages, not less than the equivalent of the sum lost, in addition to the latter amount. If both the winner and the loser have perpetrated fraud, no action for recovery can be brought by either." (*Art. 2015, Civil Code*).

- (c) Suppose the loser refuses to bring the action to recover, what may be done?

ANS.: “If the loser refuses or neglects to bring an action to recover what has been lost, his or her creditors, spouse, descendants, or other persons entitled to be supported by the loser may institute the action. The sum thereby obtained shall be applied to the creditors’ claims, or to the support of the spouse or relatives, as the case may be.” (*Art. 2016, Civil Code*).

- (d) Suppose the watchers of a game of chance bet on the result of the game without, however, taking an active part in the game itself, what rules should be applied?

ANS.: “The provisions of Articles 2014 and 2016 apply when two or more persons bet in a game of chance, although they take no active part in the game itself.” (*Art. 2017, Civil Code*).

- (e) To prevent *pure speculation* which really amounts to gambling, what does the Civil Code provide?

ANS.: “If a contract which purports to be for the delivery of goods, securities or shares of stock is entered into with the intention that the difference between the price stipulated and the exchange or market price at the time of the pretended delivery shall be paid by the loser to the winner, the transaction is null and void, and the loser may recover what he has paid.” (*Art. 2018, Civil Code*).

(6) ‘Gambling’ Distinguished from ‘Betting’

While generally gambling on the results of a game of chance is prohibited, betting (which concerns itself with games of skill, like chess) is ordinarily allowed.

Thus, the law says:

“The loser in any game which is *not* one of chance, when there is no local ordinance which prohibits betting therein, is under obligation to pay his loss, unless the amount thereof is excessive under the circumstance.” (*Art. 2020, Civil Code*).

(NOTE: The provision in the Revised Penal Code prohibiting betting on the results of a sports contest would seem to be inapplicable in cases covered by Art. 2020, otherwise said Art. 2020 would be rendered nugatory.)

(7) BAR QUESTION

A challenges *B* to a chess match, loser to pay the winner P100,000. *B* accepts the challenge. *A* wins the match but *B* refuses to pay. May *A* sue *B* for the P100,000? Why?

ANS.: Unless there is a local ordinance prohibiting betting in a chess match, and unless, considering the circumstances of the case, the sum of P100,000 is excessive (it would not be if, for example, the players were millionaires), *A* may successfully sue *B* for the P100,000. This is because chess is *not* a game of chance.

(8) ‘In pari delicto’ Rule Inapplicable to Inexistent and Void Contracts

This principle does not apply with respect to inexistent and void contracts. In *in pari delicto non oritur actio* denies all recovery to the guilty parties *inter se*. It applies to cases where the nullity arises from the illegality of the consideration or the purpose of the contract. When two persons are equally at fault, the law does not relieve them. The exception to this general rule is when the principle is invoked with respect to inexistent contracts. (*Yu Bun Guan v. Elvira Ong*, GR 144735, October 18, 2001).

Art. 1413. Interest paid in excess of the interest allowed by the usury laws may be recovered by the debtor, with interest thereon from the date of the payment.

COMMENT:**Meaning of Excess**

Strictly speaking, and using the former Usury Law as a basis, it would seem under this Article that the excess referred to is the amount *in excess* of:

- (a) 14% (in case of unsecured loans)
- (b) 12% (in case of secured loans with registered real estate as security)
- (c) 2-1/2% per month; 2% per month; 14% per year (in the case of pawnshops)

The only trouble is that there is an inherent conflict in the Civil Code as to which law prevails, the Usury Law or the Civil Code.

Note also that under Central Bank Circular 905, the Usury Law has been repealed, effective January 1, 1983.

- (a) *Under Arts. 1175 and 1957 of the Civil Code*, in case of conflict, the Usury Law prevails.
- (b) *Under Art. 1961 of the Civil Code*, in case of conflict, the Civil Code applies.

[NOTE: Now then, under Sec. 6 of Act 2655 (known as the Usury Law), the person paying the usurious interest “may recover the *whole interest*, commissions, premiums, penalties, and surcharges paid and delivered” as long as the action for recovery is instituted *within two years* after such payment and delivery (that is, all the interest paid within the last *two years* prior to litigation may be recovered).]

(NOTE: It should be noted that under both theories, *legal interest on the interest* may also be recovered.)

[NOTE: In one case, the Supreme Court held that the recovery of the interest is governed by the Civil Code. In said case, however, the question of the “conflict” was not discussed. (*Cherie Paleleo v. Beatriz Cosio*, L-7667, Nov. 28, 1955).]

[NOTE: In the case, however, of *Angel Jose Warehousing Co. v. Chelda Enterprises and David Syjuico*, L-25704, Apr. 24, 1968 (see the cause as given in the comments under Art. 1175), the Court held that the *entire interest agreed upon may be recovered*, not merely that in excess of 12% or 14% as the case may be — for the entire interest agreed upon is an *indivisible* stipulation which is VOID. On the other hand, the *principal* loan must be returned because there is nothing wrong with respect to this *principal* obligation. It is only the accessory obligation (*re the interest*) that is VOID. However, interest for *default* must be paid in addition to the principal.]

Art. 1414. When money is paid or property delivered for an illegal purpose, the contract may be repudiated by one of the parties before the purpose has been accomplished, or before any damage has been caused to a third person. In such case, the courts may, if the public interest will thus be subserved, allow the party repudiating the contract to recover the money or property.

COMMENT:

(1) One Instance Where Recovery Can Be Had Even in the Presence of *Pari Delicto*

This is one case where recovery can be made even if the parties be *in pari delicto*. Note, however, that recovery can be done only:

- (a) if the purpose has not yet been accomplished;
- (b) or if damage has not been caused any third person.

(2) Example

For a reward, A promised to kill C for B. B gave the reward. Before A could kill C, B repudiated the contract. Is B allowed to do so? Yes, because here, the purpose has not yet been accomplished and no damage has as yet been caused to a third person. May B recover what he has paid? It depends on the discretion of the court. If public interest allows the party repudiating the contract to recover the money or property given. If, however, the repudiation took place after the crime has been done, such repudiation is invalid and both parties will be guilty.

(3) Comment of the Code Commission

The Code Commission has this to say: "Concerning illegal contracts, Articles 1414 (*supra.*) and 1416 (*infra.*) allow recovery by one of the parties even though both of them have acted contrary to law." (*Report of the Code Commission*, p. 27).

(4) Applicable Even if Parties Are Not Equally Guilty

The Article also applies if the parties are *not* equally guilty, and where public policy would be advanced by allowing the suit for relief. (*Bough v. Cantiveros*, 40 Phil. 209).

Art. 1415. Where one of the parties to an illegal contract is incapable of giving consent, the courts may, if the interest of justice so demands, allow recovery of money or property delivered by the incapacitated person.

COMMENT:

(1) Effect if One Party Is Incapacitated

This is another instance when recovery can be had.

(2) Example

An insane man gave money to another to kill X. May the insane man recover what he has paid? Yes, since the interest of justice so demands.

Art. 1416. When the agreement is not illegal *per se* but is merely prohibited, and the prohibition by the law is designed for the protection of the plaintiff, he may, if public policy is thereby enhanced, recover what he has paid or delivered.

COMMENT:

(1) Contracts Illegal Per Se and Those Merely Prohibited

This Article distinguishes between contracts that are:

- (a) *illegal per se*;
- (b) and *merely prohibited contracts*.

(2) Illegal Per Se

Illegal *per se* contracts are those *forbidden* because of *public* interest.

(3) Merely Prohibited

Merely prohibited contracts are those forbidden because of *private* interests. Here *recovery* is *permitted*, provided that:

- (a) the contract is not illegal *per se*,
- (b) the prohibition is designed for the protection of the plaintiff,

- (c) and public policy would be enhanced by allowing the recovery.

(4) Examples

A donated to B everything that he (A) possessed and owned, leaving nothing for himself. This is prohibited but not illegal *per se*. Since public policy is hereby enhanced, A will be allowed to recover, at least that necessary for his own support and the support of his relatives.

Alejandro Ras v. Estela Sua and Ramon Sua **L-23302, Sept. 25, 1968**

FACTS: Alejandro Ras, after having acquired a four-hectare parcel of land from the National Abaca and Other Fibers Corporation (NAFCO), leased, before the expiration of 10 years from such acquisition, the land in favor of defendant spouses (Ramon and Estela Sua). In view of the failure of the lessees to comply with the terms of the lease contract (*e.g.*, failure to pay rentals), Ras sued for the rescission of the contract. The lessees contended, among other things, that the lessor Ras had no right to sue because of a violation of Rep. Act 477, prohibiting the alienation or encumbering of land acquired from the NAFCO within 10 years from the issuance of the corresponding certificate of title. **Issue:** Considering the *pari delicto* doctrine, may Ras successfully sue for the recovery of the land?

HELD: Yes, Ras may still sue for the recovery of the land. RA 477 is *silent* as to the consequence of the encumbering of the land within the 10-year prohibited period. But considering that the aim of the government in allowing the distribution or sale of disposable public lands to deserving applicants is to enable the landless citizens to own land they can work on, and considering that the reversion of these lands to the government is penal in character, reversion cannot be construed to be implied from the provision prohibiting certain acts. Where, as in this case, the interest of the individual outweighs the interest of the public, strict construction of a penal provision is justified under Art. 1416 of the Civil Code.

Art. 1417. When the price of any article or commodity is determined by statute, or by authority of law, any person paying any amount in excess of the maximum price allowed may recover such excess.

COMMENT:

(1) Rule in Case of Payment in Excess of Maximum Price

Purpose of the Article: To curb the evils of profiteering.

(2) Example

If the ceiling price for a pack of cigarettes is pegged at P300.00 a carton and you paid P400.00 for it, you may recover the excess of P100.00.

Art. 1418. When the law fixes, or authorizes the fixing of the maximum number of hours of labor, and a contract is entered into whereby a laborer undertakes to work longer than the maximum thus fixed, he may demand additional compensation for service rendered beyond the time limit.

COMMENT:

(1) Hours of Labor

This concerns *hours of labor*. It should be noted that the Eight-Hour Labor Law applies only to employments in industry or occupation performed for profit or gain. (*Department of Public Service Labor Union v. CIR, et al., L-15458, Jan. 28, 1961*).

(2) Basis of Minimum Wage Rates

The basis of the minimum wage rates is *not* more than *eight hours* daily labor in the case of employees working in non-agricultural enterprises, and not more than the customary hours of work in the case of *agricultural workers*. (*Art. 1, Sec. 3, Code of Rules and Regulations to Implement the Minimum Wage Law, as Amended*).

(3) Sick and Vacation Leaves**Re Mario B. Chanliongco
79 SCRA 364**

If the husband is an employee, his unused leaves (whether vacation or sick leaves) are regarded as conjugal, the same being compensation for services rendered. They are, therefore, not gratuities.

Art. 1419. When the law sets, or authorizes the setting of a minimum wage for laborers, and a contract is agreed upon by which a laborer accepts a lower wage, he shall be entitled to recover the deficiency.

COMMENT:**(1) Minimum Wage — No Waiver of Right**

“No worker or organization of workers may voluntarily or otherwise, individually or collectively, waive any rights established under this Act, and *no* agreement or contract, oral or written, to accept a lower wage or less than any other benefit required under this act shall be valid.” (*Minimum Wage Law*).

**Ineceta Alfanta v. Nolasco Noe, et al.
L-32362, Sept. 19, 1973
(Social Function of Property Ownership)**

Under the Constitution, property ownership has been impressed with a social function. This implies that the owner has the obligation to use his property not only to benefit himself but society as well. Hence, it provides that in the promotion of social justice, the State shall regulate the acquisition, ownership, use, enjoyment, and disposition of private property, and equitably diffuse property ownership and profits. The Constitution also ensures that the worker shall have a just and living wage which should assure for himself and his family an existence worthy of human dignity, and give him opportunities for a better life.

(2) Minimum Wages for Household and Domestic Helpers

Under Presidential Decree 99 (also found in Chapter III, Title III, Book III, Labor Code of the Philippines), any house-helper who before the promulgation of the decree was already

receiving a compensation higher than that prescribed therein, shall not suffer any decrease in compensation. Furthermore, the minimum rates given here shall be in ADDITION to the househelper's lodging, food, and medical attendance.

Recent legislation has caused an upward revision of the minimum wage.

(3) Penalty

“Any employer who underpays an employee is liable to the employee affected in the amount of the *unpaid wages with legal interest*. Action to recover such liability may be maintained in any competent court by any one or more employees on behalf of himself or themselves. The court in such action shall in addition to any judgment awarded to the plaintiff or plaintiffs, allow a *reasonable attorney's fee*.”

(4) When Wages Should Be Paid

“Wages shall be paid *not* less often than once every two weeks or twice a month at intervals, not exceeding sixteen days. In the case of employees hired to perform a task, the completion of which required more than a fortnight, and in respect of whom intervals for the payment of wages are not otherwise fixed by collective bargaining or arbitration award, it shall be the duty of the employer:

- (a) to make payment on account not less often than once every two weeks or twice a month at intervals not exceeding sixteen days; and
- (b) to make a final settlement within two weeks after the completion of the task.” (*RA 602, Sec. 10[b]*).

**San Miguel Corporation and Francisco
Andres v. The Hon. Secretary of Labor, et al.
L-39195, May 16, 1975**

ISSUES:

- (1) If an employee, because of the high cost of living and the difficulties of supporting a family misrepresents to the drug company where he works that he needs

certain drugs as medicine when his purpose is to sell the same, may he be punished by the company?

- (2) Can a decision of the National Labor Relations Commission (NLRC) and of the Secretary of Labor be subject to judicial review if said judicial review is not provided for in the Presidential Decree — on the theory of “separation of powers”?

HELD:

- (1) Yes, the employee may be punished, for his conduct should not be tolerated — the same being a misrepresentation or deception. On the other hand, in view of the high cost of living and the difficulties of supporting a family, it is not surprising that members of the wage-earning class would do anything possible to augment their small income. However, in view of the state of necessity he found himself in (and in case of a promise on his part not to repeat the offense) *dismissal* would be a drastic punishment. The dismissed employee should be *reinstated, but without backwages* because his dismissal had been made in good faith. The loss of wages from time of dismissal to time of reinstatement, under the circumstances, would be sufficient penalty (In this case, the time interval was around three years).
- (2) Yes, the decision is subject to judicial review. It is generally understood that as to administrative agencies exercising *quasi-judicial* or legislative power, there is an underlying power in the courts to scrutinize the acts of such agencies on questions of law and jurisprudence, *even though no right of review is given by statute.* (73 C.J.S. 506, note 56). The purpose of judicial review is to keep the administrative agency within its jurisdiction and to protect the substantial rights of the parties affected. This is part of the system of checks and balances. Thus, the courts may declare an administrative act illegal or corrupt or capricious. (*See Borromeo v. City of Manila & Rodriguez Lanuza*, 62 Phil. 516 and *Villegas v. Auditor-General*, L-21352, Nov. 29, 1966).

**Bacata v. Workmen's Compensation
Commission
L-23992, Oct. 27, 1975**

FACTS: Deceased was a driver mechanic of a company engaged in an ILLEGAL TRADE, the manufacture of blasting caps. One day he dies because of a dynamite explosion. *Issue:* Is his death compensable under the Workmen's Compensation Law?

HELD: Yes, even if the trade was illegal. After all, it was his employers, not he, who were engaged in illegal trade. Moreover, the Workmen's Compensation Law is a SOCIAL legislation.

Art. 1420. In case of a divisible contract, if the illegal terms can be separated from the legal ones, the latter may be enforced.

COMMENT:

Illegal Terms of a Contract

The contract may be indivisible or divisible.

- (a) If *indivisible* the whole contract is *void*, even if only *some terms* are *illegal*.
- (b) If *divisible*, the legal terms may be enforced if same can be separated from the illegal terms. (*Art. 1420*).

[*NOTE:* He who wants to enforce a contract must show how much of the cause is legal; otherwise, if partly legal and partly illegal, it will result in the contract being considered as wholly void. (*Lichauco v. Martinez*, 6 Phil. 594).]

Art. 1421. The defense of illegality of contracts is not available to third persons whose interests are not directly affected.

COMMENT:

Defense of Illegality Not Generally Available to Third Persons

- (a) Even if a contract is illegal, the defense of illegality may be set up only by those whose interest are directly affected.
- (b) Note the rule for *annullable* (Art. 1397, Civil Code) and *unenforceable* contracts. (Art. 1408, Civil Code).

Art. 1422. A contract which is the direct result of a previous illegal contract, is also void and inexistent.

COMMENT:

Contract That Is the Direct Result of a Previous Illegal Contract

This Article is a new provision of the Civil Code. *Example:* A promised to give B a car as a reward after B has killed C. Later, after the killing, the contract was changed to a lease of a big house for a certain period. The second contract here is the direct result of a previous illegal contract and is, therefore, null and void.

**E. Razon, Inc. v. Phil. Ports Authority, et al.
GR 75197, Jun. 22, 1987**

FACTS: ERI is a corporation organized for the main purpose of bidding for the contract to manage all the piers in South Harbor, Manila. ER allegedly owned 100% equity. After a public bidding, ERI was awarded in 1966 a 5-year contract to operate arrastre service at the South Harbor. In 1971, the Bureau of Customs called for a new bidding. ERI secured an injunction in the CFI (now RTC), but the Supreme Court ordered the holding of a public bidding. ERI emerged as the Bidding Committee's unanimous choice. A new contract for 5 years effective 1974, renewable for another 5 years, was executed between ERI and the Bureau of Customs. In 1978, ERI initiated negotiations with Philippine Ports Authority, either for renewal of contract for public bidding. The PPA manager did not act on the request, due to the desire of people close to the President to take over ERI.

Thereafter, ER, then owner of 93% of ERI's equity was allegedly coerced by emissaries from the President into indorsing

in blank ERI's stock certificates covering 60% equity, and ER did not get a single centavo for these shares. The party close to the President was the latter's brother-in-law. After the transfer, a new group took control over ERI. ER was, however, retained as company president. When the contract of ERI expired, it was extended for a term of 8 years beginning July, 1980.

On Feb. 26, 1986 after the ouster of the former government administration, ER took active control. In July, 1986, the PPA informed ERI that it was cancelling the management contract and taking over the cargo handling operations. ERI and ER contend that they were denied their right to due process when PPA cancelled the Management Contract without prior hearing and investigation.

HELD: The transfer of the shares of stock representing 60% equity to persons fronting for President Marcos' brother-in-law was, at the very least, voidable for lack of consent, or altogether void, being absolutely fictitious or simulated. The invalidity springs not from vitiated consent nor absolute want of monetary consideration, but for its having had an unlawful cause — that of obtaining a government contract in violation of law.

While generally, the *causa* of the contract must not be confused with the motives of the parties, this case squarely fits into the exception that the motive may be regarded as *causa* when it predetermines the purpose of the contract. On the part of the President's brother-in-law, the motive was to be able to contract with the government which he was then prohibited by law from doing. On ER's part, to be able to renew his management contract. Thus, by transferring 60% of the shares in his company to the President's brother-in-law, ER was able to secure an 8-year contract with PPA and, for six years before its cancellation, benefit from its proceeds. The transfer of the control of ERI from ER to the President's brother-in-law, which is null and void, served as the direct link to ERI's obtaining the management contract. Being the direct consequence and result of a previous illegal contract, the Management Contract itself is null and void as provided in Art. 1422.

TITLE III. — NATURAL OBLIGATIONS

(New, except Article 1427.)

INTRODUCTORY COMMENT:

Comment of the Code Commission Re Natural Obligations

In all the specific cases of natural obligations recognized by the Civil Code, there is a moral duty, but not a legal duty to perform or to pay, but the person thus performing or paying feels that in good conscience, he should comply with his undertaking which is based on moral grounds. Why should the law permit him to change his mind, and recover what he has delivered or paid? Is it not wiser and more just that the law should compel him to abide by his honor and conscience? Equity, morality, natural justice — those are after all the abiding foundations of positive law. A broad policy justifies as a legal principle that would encourage persons to fulfill their obligations. (*Commission Report*, pp. 58-59).

Art. 1423. Obligations are civil or natural. Civil obligations give a right of action to compel their performance. Natural obligations, not being based on positive law but on equity and natural law, do not grant a right of action to enforce their performance, but after voluntary fulfillment by the obligor, they authorize the retention of what has been delivered or rendered by reason thereof. Some natural obligations are set forth in the following articles.

COMMENT:

(1) Civil and Natural Obligations Distinguished

This Article distinguishes between *civil* and *natural* obligations.

(2) ‘Voluntary Fulfillment’ Defined

“Voluntary fulfillment” means that the debtor complied with the same *even if he knew that he could not have been legally forced to do so*. Thus, payment through a coercive process of the writ of execution issued at the instance and insistence of the prevailing party, is NOT considered voluntary, and the provisions of the law on natural obligations cannot be applied thereto. (*Manila Surety & Fidelity Co. v. Lim, L-9343, Dec. 29, 1959*). In case of *partial* voluntary fulfillment, the balance cannot be recovered, since on said balance, there has not yet been created a legal obligation.

(3) Undue Payment Distinguished from Natural Obligation

If I pay a debt that has *prescribed* —

- (a) *not knowing* it has prescribed, I can recover on the ground of *undue payment*.
- (b) *knowing* it has prescribed, I cannot recover for this would be a case of a *natural* obligation.

[NOTE: Payment thru a coercive process of the writ of execution issued at the instance and insistence of the prevailing party, is NOT considered voluntary and the provisions of the law on natural obligations, cannot be applied thereto. (*Manila Surety & Fidelity Co. v. Lim, L-9343, Dec. 29, 1959*).]

(4) No Juridical Tie in Moral Obligations

While there is a juridical tie in *natural* obligations, there is none in moral obligations. Thus, giving a legal assistance to one’s employee (who has been accused of a crime) is merely a moral obligation, and the employee cannot recover attorney’s fee from the employer. (*De la Cruz v. Northern Theatrical Enterprises, Inc., et al., 50 O.G. 4225, Sept. 1954*).

Similarly, a Christmas bonus, not yet given to employees, is *not* generally a demandable and enforceable obligation; nor may it be considered a natural obligation for there has been *no* voluntary performance as yet. The Courts cannot order therefore the grant of the bonus (*Ansay, et al. v. Board of Directors of the NDC, L-13667, Apr. 29, 1969*) unless:

- (a) it had been made a *part* of the wage or salary (*PECO v. CIR, L-5103, Dec. 24, 1952*);
- (b) or may be granted on equitable considerations, as when it used to be given in the past, although withheld in succeeding years. (*Heacock v. NLU, L-5577, Jul. 31, 1954*).

(5) Example of Other Natural Obligations

Art. 1423 says: “Some natural obligations are set forth in the following articles.” Hence, there may be other natural obligations.

Examples:

- (a) obligation to pay interest for use of money, even if not agreed upon in writing. (*See Arts. 1956, 1960, Civil Code*).
- (b) duty to support natural or spurious children (even if not recognized voluntarily or by judicial compulsion and even if there is a judgment denying recognition).
- (c) giving of material and financial assistance to children upon their marriage.

(6) Conversion of Moral Obligations to Civil Obligations

Moral obligations may be converted into civil obligations.

Example: Acknowledgment of a prescribed debt.

Art. 1424. When a right to sue upon a civil obligation has lapsed by extinctive prescription, the obligor who voluntarily performs the contract cannot recover what he has delivered or the value of the service he has rendered.

COMMENT:

(1) Effect of Extinctive Prescription

By virtue of *extinctive* prescription, a right or property has been lost. Hence, the existence of the Article.

(2) Example of the Article’s Application

A’s debt to C has been extinguished by prescription. Yet A, knowing of the prescription, voluntarily paid the prescribed

debt. *A* cannot now recover what he has paid *C*. Prescribed debt may indeed give rise to new obligation. (*Villaroel v. Estrada*, 71 *Phil.* 140).

Art. 1425. When without the knowledge or against the will of the debtor, a third person pays a debt which the obligor is not legally bound to pay because the action thereon has prescribed, but the debtor later voluntarily reimburses the third person, the obligor cannot recover what he has paid.

COMMENT:

(1) Payment by a Third Person

Here the third person pays:

- (a) *without the knowledge* (of the debtor);
- (b) *or against the will* (of the debtor).

(2) Example

A owes *B* P700,000. But the debt soon prescribes. Later *C*, against the consent of *A*, pays *B* the P700,000. *A* here does not have to reimburse *C* because he (*A*) has not at all been benefited by the transaction. However, *A* later voluntarily reimburses *C*. May *A* now recover what he has given to *C*?

ANS.: No more. This is the express provision of the law.

(3) Payment With Debtor's Consent

If payment is made with the consent of the debtor, a *civil* obligation arises.

Art. 1426. When a minor between eighteen and twenty-one years of age who has entered into a contract without the consent of the parent or guardian, after the annulment of the contract voluntarily returns the whole thing or price received, notwithstanding the fact that he has not been benefited thereby, there is no right to demand the thing or price thus returned.

COMMENT:**(1) Contracts by Minors Between 18 and 21 — When There Has Been Annulment**

- (a) This applies to minors between 18 and 21 when the contract was *without* parental consent. (Here the minor is considered *mature enough*.)
- (b) Here *after* annulment, there was a VOLUNTARY return.

(2) Example

A, a minor, entered into a contract with a *sui juris*, without the consent of his (A's) parents. In said contract, A received a car. This car was afterwards destroyed by a fortuitous event. Later when the contract was annulled, A returned voluntarily the value of the car although he had not profited or benefited a single centavo from the car. Has he now the right to demand that the price be returned? No more.

(3) Majority Age

The age of majority today is 18.

Art. 1427. When a minor between eighteen and twenty-one years of age, who has entered into a contract without the consent of the parent or guardian, voluntarily pays a sum of money or delivers a fungible thing in fulfillment of the obligation, there shall be no right to recover the same from the obligee who has spent or consumed it in good faith.

COMMENT:**(1) Contracts by Minors — No Annulment Yet**

- (a) Generally, annulment requires mutual restitution. Here, the obligee who has spent or *consumed* the object in *good faith* is not required to restore.
- (b) Good faith of the obligee must be present *at the time of* spending or *consuming*.
- (c) Note that the majority age today is 18. And “fungible” here really means “consumable.”

(2) Query

Suppose the object is non-consumable, does the Article apply?

ANS.: Yes, if there has been loss by fortuitous event or *alienation in good faith* (this is equivalent to spending or consuming it), if the proceeds thereof have already been spent in good faith.

Art. 1428. When, after an action to enforce a civil obligation has failed, the defendant voluntarily performs the obligation, he cannot demand the return of what he has delivered or the payment of the value of the service he has rendered.

COMMENT:**(1) Winner in an Action to Enforce a Civil Obligation**

Here the defendant may have realized that he should have lost the case, instead of winning it, thus the existence of the Article.

(2) Example

A owes B P500,000. B brings a suit against A, but B loses the case for insufficient evidence. No appeal is made from the decision, and the judgment becomes final. Later, A paid B voluntarily the debt. May A now recover from B what he (A) has paid? No.

Art. 1429. When a testate or intestate heir voluntarily pays a debt of the decedent exceeding the value of the property which he received by will or by the law of intestacy from the estate of the deceased, the payment is valid and cannot be rescinded by the payer.

COMMENT:**(1) Rule in Case of Payment of Debts Beyond Value of the Decedent's Estate**

Heirs inherit obligations only to the extent of the value of the inheritance. This is the reason for the Article, coupled with the basis for the natural obligation.

(2) Example

A dies, leaving an estate of P10,000,000 and debts amounting to P15,000,000. His heir here is not expected to make up for the difference, BUT if he does so voluntarily, then he cannot recover said difference. After all, one does have a moral duty to see to it that the dead relative's or friend's obligations in life are all carried out. Here, the heir is not really required by law to shoulder the deficit, but since he does so voluntarily, he cannot now back out.

Art. 1430. When a will is declared void because it has not been executed in accordance with the formalities required by law, but one of the intestate heirs, after the settlement of the debts of the deceased, pays a legacy in compliance with a clause in the defective will, the payment is effective and irrevocable.

COMMENT:**(1) Payment of Legacies Despite the Fact That the Will Is Void**

If the will is void, the legacy would also be void and the deceased is considered to have died without a will. This is the reason for the existence of the Article.

(2) Example

In a will defective for lack of the needed legal formalities, X, a friend, was given a legacy. The legacy is void, and the whole estate should go to the intestate heirs. If however, the intestate heirs give X the legacy, they cannot get it back now, provided that the debts of the deceased have been settled.

(3) Analogous Cases

By *analogy*, all alienations defective for lack of the proper formalities may be included under Art. 1430.

TITLE IV. — ESTOPPEL (n)

INTRODUCTORY COMMENT:

Comment of the Code Commission on Estoppel

“An important branch of American Law is estoppel. It is a source of many rules which work out justice between the parties, thru the operation of the principle that an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon.” (*Report of the Code Commission*, p. 59).

Art. 1431. Through estoppel an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon.

COMMENT:

(1) Concept of Estoppel

“Speaking generally, it may be said that estoppel is a bar which precluded a person from denying or asserting anything contrary to that which has been, in contemplation of law, established as the truth either by acts of judicial or legislative officers, or by his own deed or representation either express or implied.” (*19 Am. Jur.* 601).

[NOTE: In *Lopez v. Ochoa* (L-7955, May 30, 1958), the Supreme Court held that waiver and estoppel are frequently used as convertible terms. The doctrine of waiver belongs to the family of, is of the nature of, is based on, estoppel. The essence of waiver is estoppel, and where there is no estoppel, there is no waiver. This is especially true where the waiver relied upon is constructive or implied from the conduct of a party. Thus, when it is asserted that a “party is in estoppel,” this is the same as saying that said party had made a waiver.]

**Royales v. Intermediate Appellate Court
L-65072, Jan. 31, 1984**

If recourse to the barangay courts is not availed of, the complaint may be dismissed for lack of a cause of action, unless the requisite has been waived by failure to set up a timely objection. The aggrieved person may be deemed to be in estoppel.

**Ruperto Pureza v. CA, Asia Trust Development
Bank and Spouses Bonifacio & Crisanta Alejandro
GR 122053, May 15, 1998**

A principle of equity and natural justice, the application of the principle of *estoppel* is proper and timely in heading off petitioner's shrewd efforts at renouncing his previous acts to the prejudice of parties who had dealt with him honestly and in good faith.

In the case at bar, petitioner having performed affirmative acts upon which the respondents based their subsequent actions, cannot thereafter refute his acts or renege on the effects of the same, to the prejudice of the latter. To allow him to do so would be tantamount to conferring upon him the liberty to limit his liability at his whim and caprice, which is against the very principles of equity and natural justice as abovestated.

**Adoracion E. Cruz, et al. v. CA
and Sps. Eliseo & Virginia Malolos
GR 126713, Jul. 27, 1998**

FACTS: Petitioners, in their transactions with others, have declared that the other lands covered by the Memorandum of Agreement are absolutely owned, without indicating the existence of a co-ownership over such properties.

Issue: Are petitioners estopped from claiming otherwise?

HELD: Yes, because the petitioners' very own acts and representations, as evidenced by the deeds of mortgage and of sale, have denied such co-ownership. Under the principle of estoppel, petitioners are barred from claiming co-ownership of the lands in issue. In estoppel, a person, who by his deed or conduct has induced another to act in a particular manner, is barred from

adopting an inconsistent position, attitude or course of conduct that thereby causes loss or injury to another. It further bars him from denying the truth of a fact which has, in the contemplation of law, become settled by the acts and proceedings of judicial or legislative officers or by the act of the party himself, either by conventional writing or by representations, express or implied of *in pais*.

(2) Origin of Estoppel

The doctrine of estoppel has its origin in equity, and is based on moral rights and natural justice. Its applicability to any particular case depends to a very large extent upon the special circumstances of the case. (*Mirasol v. Municipality of Tabaco*, 43 Phil. 610).

(3) Examples of Estoppel

- (a) If a husband in a sworn declaration constituting a family home has stated in said documents that he was married, naming his wife, he *cannot* thereafter be heard to say that he and the girl are not married. Therefore, the family home should be considered as conjugal property. (*Montoya v. Ignacio, et al.*, L-10518, Nov. 29, 1957).
- (b) A holder of a promissory note given because of gambling who indorses the same to an innocent holder for value and who assures said party that the note has no legal defect, is estopped from asserting that there had been an illegal consideration for the note, and so, he has to pay its value. (*Rodriguez v. Martinez*, 5 Phil. 67).
- (c) A person who alleged at one time in court that he was the owner of a certain cabaret cannot afterwards deny his ownership thereof. (*Patricio v. Patricio*, 78 Phil. 759).
- (d) A person claiming for his salary was selling his interest in the stock of a corporation to said corporation. The corporation refused to consider the sale unless the claim for salary was omitted. So, the seller drew another contract, this time with no mention of the salary. He cannot now claim the salary in view of estoppel. (*Herman v. Radio Corporation of the Phil.*, 50 Phil. 490).

- (e) A vendee *a retro* who at one time recognized ownership in the subject matter by the vendor *a retro* cannot now claim ownership over the same. (*Matienzo & Palileo v. CFI of Laguna*, 64 Phil. 542).
- (f) “He who prevents a thing from being done may *not* avail himself of the non-performance which he himself has occasioned,” for the law says to him in effect, ‘this is your own act, and therefore you are *not* damnified.’ Where, therefore, a taxpayer repeatedly requested for reinvestigation of his case and therefore persuaded the government to postpone collection of the tax, he cannot set up prescription of the action. (*Coll. v. Suyoc Consol*, L-11527, Nov. 25, 1958).
- (g) If the registered owner of a *private* or public vehicle sells it to another, but does not cancel its registration under his name, he will still be responsible if the buyer causes damage or injury to another. He will be *estopped* from asserting that the property had already been transferred by him to another. The Motor Vehicle Law requires registration so as to *identify* the owner in case of an accident or injury on the highways. Responsibility is thus fixed on a definite individual, the registered owner. If this were not the rule, it would be very easy for the registered owner to escape responsibility by simply transferring the property to an indefinite person or to one who possesses no property with which to respond financially for the damage or injury done. *However*, the registered owner who has already conveyed or transferred a vehicle has a *right to be indemnified* by the vendee or transferee for the amount that he may be required to pay as damages to the person injured by the vehicle. (*Erezo, et al. v. Jepte*, L-9605, Sept. 30, 1957; see *Montoya v. Ignacio*, L-5868, Dec. 29, 1953; *Roque v. Malibay Transit*, L-8561, Nov. 18, 1955 and *Vda. de Mesina v. Cresencia*, 52 O.G. No. 10, p. 4606).
- (h) A government employee who accepts the benefits accruing from the abolition of his office is *estopped* from questioning the validity of the abolition and is deemed to have waived the right to contest the same. (*Magana v. Agregado, et al.*, L-12180, Apr. 29, 1960).

**Fieldman's Insurance Co., Inc. v.
Mercedes Vargas Vda. de Songco, et al.
L-24833, Sept. 23, 1968**

FACTS: Federico Songco, a man of scant education being only a first grader, owned a *private* jeepney, which was covered by a *common carrier's* liability insurance by the Fieldman's Insurance Co. The contract was procured by the company's agent, who induced Federico to have the vehicle insured, although it was NOT a COMMON CARRIER, but a private one. In fact the 42-year-old son of Federico had misgivings, for the vehicle was merely for *private* use. The agent assured Federico, however, that the contract was valid. Sometime later, the vehicle was involved in a collision, resulting in death to Federico and one of his sons, and physical injuries to two others. When the surviving widow and other children sued the Company under the terms of the contract, the latter alleged that the same was not valid, for it was not a common carrier. *Issue:* Is the Company liable?

HELD: Yes, the Company is liable on account of *estoppel*. Moreover, the contract of insurance is one of perfect good faith (*uberrima fides*) not for the insured alone, but equally so for the insurer; in fact, it is more so for the latter, since its dominant bargaining position carries with it stricter responsibility. (*See Qua Chee Gan v. La Union & Rock Insurance Co., Ltd., 93 Phil. 85 [1955].*)

**Manila Electric Co. v. Court of Appeals
L-33794, May 31, 1982**

If a party fails to object to the construction of an electric sub-station within his property, and only asked for assurance that the station would not be a nuisance or dangerous, he can be said to be in "contractual estoppel."

**Pantranco v. Court of Ind. Rel.
L-9736, May 20, 1957
Instance Where Estoppel Does Not Apply**

FACTS: Under public service regulations, a public service operator is *not* allowed to employ a person who has

been convicted of the crime of theft. Now, then, a certain public service operator employed unknowingly such a convict. May he now be allowed to *dismiss* said convict in compliance with the regulations?

HELD: Yes, for estoppel should *not* apply. Otherwise, two things may result. *Firstly*, the regulation may be circumvented were we to apply estoppel. *Secondly*, we would be unnecessarily punishing an employer despite his desire to comply with the regulation upon his discovery that a disqualification existed.

**Luzon Stevedoring Co., Inc. v. Luzon
Marine Dept. Union, et al.
101 Phil. 257**

Estoppel by laches (unreasonable delay in making a claim in court) does not apply to employees in claiming *overtime pay*, for to allow estoppel in this case would be to bring about a situation whereby the employee or laborer, who *cannot expressly* renounce the right to extra compensation under the law, may be compelled to accomplish the same thing by mere silence or lapse of time, thereby frustrating by *indirection* the purpose of the law.

However, laches may favor the inference that no such overtime work had been made; or that, even if it existed, it has already been *duly compensated*.

No estoppel can be invoked if the complaining party has not been misled. (*Cristobal v. Gomez*, 50 Phil. 810).

If a public officer makes an erroneous application and enforcement of the *law*, he is *not* considered in estoppel. (*Phil. Long Distance Tel. Co. v. Coll. of Int. Rev.*, 90 Phil. 674). However, *other affirmative* acts of officials may raise estoppel against the government. (*Bachrach Motor Co. v. Unson*, 50 Phil. 981 and *Boada v. Posadas*, 58 Phil. 184).

[NOTE: However, *omission* or *neglect* of government officials does not create estoppel against the government. (*Ibid*; see also *Pineda v. Court of First Instance*, 52 Phil. 803 and *Central Azucarera de Tarlac v. Collector*, L-11002, Sept. 30, 1958).]

**Social Security Commission v. Ponciano L.
Almeda and Eufemia P. Almeda
GR 75428, Dec. 14, 1988**

When respondents negotiated for the reduction of the attorney's fees, they acquiesced to the stipulation therefor and cannot now question its validity. It is undisputed that respondents requested merely for a reduction of the attorney's fees. In Resolution 286, the Social Security System (SSS) approved respondent's request and reduced the attorney's fees from 20% to 15%. Respondents thereafter paid *without protest* the total obligation, including attorney's fees equivalent to 15%. The claim of respondent Ponciano Almeda that he *verbally protested* the collection of attorney's fees is belied by the above-cited SSS Resolution which shows that Almeda merely requested the *reduction* of attorney's fees. Between Almeda's testimony, which is obviously self-serving, and the SSS Resolution, which is a public document, the latter certainly carries greater probative value. Clearly then, respondents were indeed in *estoppel*.

**Laurel v. Civil Service Commission
GR 71562, Oct. 28, 1991**

FACTS: Petitioner did not raise the issue that the position of Provincial Administrator is primarily confidential. On the contrary, he submits that said position is not primarily confidential, for it belongs to the career service. He even emphasized this fact with an air of absolute certainty. He changed his mind only after the Civil Service ruled that the "prohibitive mantle on nepotism would include designation, because what cannot be done directly cannot be done indirectly" and, more specifically, when he filed his motion to reconsider said resolution.

HELD: Per Article 1431 of the Civil Code, thru estoppel, an admission or representation is rendered conclusive upon the person making it, and cannot be denied or disproved as against the person relying thereon.

- (k) A petitioner cannot be estopped in questioning the validity of a customer's agreement and from denying the effects of

his conduct. (*Lim v. Queensland Tokyo Commodities, Inc.*, GR 136031, January 4, 2002).

**Jefferson Lim v. Queensland Tokyo
Commodities, Inc.
GR 136031, Jan. 4, 2002**

FACTS: Private respondent Queensland Tokyo Commodities, Inc. (Queensland) is a duly-licensed broker engaged in the trading of commodities futures with full membership and with a floor trading right at the Manila Futures Exchange, Inc. (MFEI).

Sometime in 1992, Benjamin Shia, a market analyst and trader of Queensland, was introduced to petitioner Jefferson Lim. Shia suggested that Lim invest in the foreign exchange (forex) market, trading U.S. dollar against the Japanese yen, British pound, Deutschemark, and Swiss franc. Because respondent Queensland dealt in pesos only, it had to convert \$5,000 in manager's check to pesos, amounting to P125,000 since the exchange rate at that time was P25 to \$1. To accommodate petitioner's request to trade right away, it advanced the P125,000 from its own funds while waiting for the manager's check to clear. Thereafter, a deposit notice in the amount of P125,000 was issued to Queensland, and which was sent to Lim who received it. Then, Lim signed a customer's agreement. Soon thereafter, petitioner Lim was allowed to trade with respondent company which was coursed thru Shia by virtue of the blank order forms. Meanwhile, on October 22, 1992, respondent learned that it would take 17 days to clear the manager's check given by petitioner. Thereupon, respondent asked Shia to talk to petitioner for a settlement of his account but petitioner refused to talk with Shia. The latter made follow-ups for more than a week beginning October 27, 1992. Owing to the fact that petitioner disregarded this request, respondent was compelled to engage the services of a lawyer, who sent a demand letter to petitioner but which went unheeded. Thus, respondent filed a complaint against petitioner, for collection of a sum of money.

On April 22, 1994, the trial court ordered the dismissal of the complaint as well as that of the defendant's coun-

terclaim. On appeal by Queensland, the Court of Appeals reversed and set aside the trial court's decision.

ISSUE: Can petitioner be estopped in questioning the validity of a customer's agreement and from denying the effects of his conduct?

HELD: No. It is uncontested that petitioner had, in fact, signed the customer's agreement in the morning of October 22, 1992, knowing fully well the nature of the contract he was entering into. The customer's agreement was duly-notarized and as a public document it is evidence of the fact, which gave rise to its execution and of the date of the latter. (*Sec. 23, Rule 132, Rules of Court*). Next, petitioner paid his investment deposit to respondent in the form of a manager's check in the amount of \$5,000 as evidenced by PCI Bank Manager's check 69007, dated October 22, 1992. All these are *indicia* that petitioner treated the customer's agreement as a valid and binding contract.

Clearly, by his own acts, petitioner is estopped from impugning the validity of the customer's agreement. For a party to a contract cannot deny the validity thereof after enjoying its benefits without outrage to one's sense of justice and fairness.

Art. 1432. The principles of estoppel are hereby adopted, insofar as they are not in conflict with the provisions of this Code, the Code of Commerce, the Rules of Court and special laws.

COMMENT:

(1) Suppletory Effect of the General Principles of Estoppel

The principles of estoppel are only *suppletory*.

(2) Pleading of Alleged Estoppel

If facts are alleged as constituting estoppel, they must be expressly pleaded. (*Castañeda v. Yap*, 48 O.G. 3364).

Art. 1433. Estoppel may be *in pais* or by deed.

COMMENT:**(1) Kinds of Estoppel**

- (a) estoppel *IN PAIS* (equitable estoppel); this may be *estoppel*:
 - 1) by conduct or by acceptance of benefits,
 - 2) by representation or concealment,
 - 3) by silence,
 - 4) by omission,
 - 5) by laches (unreasonable delay in suing).
- (b) estoppel *BY DEED* (technical estoppel); this may be:
 - 1) estoppel by deed proper (*written instrument may also be in the form of a bond or a mortgage*).
 - 2) estoppel by judgment as a *court record* (this happens when there could have been *RES JUDICATA*). (*See Rule 131, Sec. 3[3] and Rule 39, Sec. 47, Revised Rules of Court*)

[NOTE: While res judicata makes a judgment conclusive between the parties as to things which were directly adjudged, estoppel by judgment prevents the parties from raising questions that could have been put in issue and decided in the previous case. (See Phil. Nat. Bank v. Barretto, 52 Phil. 818 and Namarco v. Macadaeg, 52 O.G. 182).]

**Makati Leasing and Finance Corporation v.
Weaver Textile Mills, Inc. &
Court of Appeals
GR 58469, May 16, 1983**

A machine movable by nature, which becomes immobilized by destination or purpose, may be treated as movable property. One who agrees to executing a chattel mortgage is *estopped* from denying the chattel mortgage on the ground that the subject matter is immovable property.

(2) Estoppel IN PAIS (Equitable Estoppel)

- (a) *Definition:* It arises when one, by his acts, representations or admissions, or by his silence when he ought to speak out, *intentionally* or thru *culpable negligence*, induces another to believe certain facts to exist, and such other rightfully *relies* and acts on such belief, so that he will be prejudiced if the former is permitted to deny the existence of such facts. (*31 Corpus Juris Secundum 237*).

Carolina Liqueze Ganzon v. CA
GR 136831, Jul. 30, 2002

Estopped *in pais*, or equitable estoppel arises when one, by his acts, representations or admissions or by his silence when he ought to speak out, intentionally or thru culpable negligence, induces another to believe certain facts to exist and such other rightfully relies and acts on such belief so that he will be prejudiced if the former is permitted to deny the existence of such facts. The real office of the equitable norm of estoppel is limited to supplying deficiency in the law, but it should not supplant positive law.

In the case at bar, the requisites for the existence of a tenancy relationship are explicit in the law and these elements cannot be done away with by conjectures.

[NOTE: It takes place in a situation where because of a party's action or omission, he is denied the right to plead or prove a fact otherwise important. (*19 Am. Jur. 634*).]

[NOTE: Its purpose is to serve the objectives of justice. It is founded on morality and fair dealing. (*19 Am. Jur. 634*).]

[NOTE: Estoppel should *not* be confused with fraud.

Firstly, estoppel exists with or without a contract; fraud presupposes an attempt to enter into a valid agreement or contract.

Secondly, while estoppel may be raised as a defense, fraud may properly be a cause of action, on account of the vitiated consent that it produces.]

(b) *Examples of estoppel in pais:*

- 1) If a vendee *a retro* agrees to accept a check in payment of the repurchase price, he cannot afterwards allege that the check is not legal tender. He is bound by his own act. (*Gutierrez v. Carpio*, 53 Phil. 334).
- 2) If the real owner of a house pretends to be merely a broker in the sale thereof, he is estopped from asserting ownership over the same. (*Bachrach Motor Co. v. Kane*, 61 Phil. 504).
- 3) If the NAMARCO has entered into a *valid* contract with a certain Federation for the sale of certain goods imported by the former, it (NAMARCO) cannot question the validity of the transaction particularly after it has received and accepted certain benefits from the Federation as a result of the contract. (*NAMARCO v. Tan, et al.*, L-17074, March 31, 1964).

(c) *Some Doctrines*

- 1) Conduct because of ignorance or mistake does *not* result in estoppel. (*Ramiro v. Grano*, 54 Phil. 744). Indeed if someone was ignorant of the truth or was mistaken, he cannot be said to be in estoppel. (*Far Eastern Surety Co. v. Court of Appeals*, L-12019, Oct. 16, 1958).
- 2) *Estoppel by laches* (unreasonable delay in bringing a court action, even if the period of prescription has not yet lapsed) bars an action to *create* a vested right (executory interest) but does not bar an action to *protect* a vested right (executed interest). (*Inton v. Quintana*, 81 Phil. 97).

[NOTE: In *Liguez v. Lopez*, 102 Phil. 577, the Supreme Court held that the rule of estoppel by laches cannot apply to prevent enforcement of the principle that a party to an illegal contract cannot recover what he has given pursuant thereto, for the latter is a rule of superior public policy.]

[NOTE: In *Viloria v. Sec. of Agriculture and Natural Resources, et al.*, L-11754, April 29, 1960,

the Court held that the *equitable defense of LACHES* requires four elements:

- a) conduct on the part of the defendant, or of one under whom he claims, giving rise to the situation of which the complaint is made and for which the complaint seeks a remedy;
 - b) delay in asserting the complainant's rights, the complainant having had knowledge or notice of the defendant's conduct and having been afforded an opportunity to institute a suit;
 - c) lack of knowledge or notice on the part of the defendant that the complainant would assert the right on which he bases his suit;
 - d) injury or prejudice to the defendant in the event relief is accorded to the complainant, or the suit is *not* held to be barred. (*See also Mejia de Lucas v. Gamponia*, 53 O.G. 667; *see also Miguel v. Catalino*, L-23072, Nov. 29, 1968).]
- 3) Just because a person is silent does not necessarily mean that he will be in estoppel. There should have been a duty or obligation to speak. (*19 Am. Jur. 663 and Lora v. Del Rosario, et al.*, [C.A.] 52 O.G. 268).
 - 4) A mere promise to perform or to omit at some future time does not necessarily result in estoppel (*promissory estoppel*). For this to exist, the promise must have been relied upon, and prejudice would result unless estoppel is applied. (*See 19 Am. Jur. 657-658*).

Nyco Sales Corp. v. BA Finance Corp.
GR 71694, Aug. 16, 1991

The lower court observed that there was already a previous transaction of discounting of checks involving the same personalities wherein any enabling resolution from Nyco was dispensed with and yet BA Finance was able to collect from Nyco and Sanshell was able to discharge its own undertakings. Such effectively places Nyco under estoppel *in pais* which

arises when one, by his acts, representation or admissions, or by his silence when he sought to speak out intentionally or thru culpable negligence induces another to believe certain facts to exist and such other rightfully relies and acts upon such belief, so that he will be prejudiced if the former is permitted to deny the existence of such facts. Nyco remained silent in the course of the transaction and spoke out only later to escape liability. This cannot be countenanced.

(3) Estoppel BY DEED

- (a) *Definition:* It is a bar which precludes a party to a deed and his privies from asserting as against the other and his privies any right or title in derogation of the deed, or from denying the truth of any material fact asserted in it. (31 CJS, p. 195).

(NOTE: There must be a *written instrument*.)

- (b) *Examples of estoppel by deed:*

- 1) If several persons, each claiming ownership over certain property deposited in a warehouse, in a written document agree it should be sold, said persons cannot later on modify the terms of the agreement. (*Cu Unjieng v. Asia Banking Corporation*, 45 Phil. 769).
- 2) If a shipper has his goods valued at only P200, he cannot later on recover damages for its value more than what he has declared in the bill of lading, even if the value of the goods be worth much more, for he is in estoppel. (*Friexas and Co. v. Pacific Mail Steamship Co.*, 42 Phil. 198).
- 3) Purchase in one's own name with another's money generally gives title to the purchaser, that is, to him who appears in the deed to have made the purchase in his own name. (See *Enriquez v. Olaguer*, 25 Phil. 641 and *Collector of Internal Revenue v. Favis, et al.*, L-11551, May 30, 1960).

- (c) *Some Doctrines*

- 1) If the deed or instrument is null and void because the

contract, let us say, is illegal, there is NO estoppel. (17 Am. Jur. 605).

- 2) Ordinarily, the person estopped must be capacitated. (19 Am. Jur. 604). But if a minor is clever enough to deceive others, estoppel may result. (See *Sia Suan v. Alcantara*, 47 O.G. 4561). Thus, minors who sell real estate pretending, by the execution of a public instrument, to have reached their majority, *cannot* be permitted afterwards to excuse themselves from compliance with the obligation assumed by them or to seek their annulment. And the circumstance that after the conveyance, they inform the vendee of their minority is of *no* moment, because their misrepresentation had already estopped them from disavowing the contract. (*Hermosa v. Zobel y Roxas*, L-11835, Oct. 30, 1958).
- 3) If a person notarizes (and is not a party to) the instrument, he is NOT in estoppel. (*Borlasa v. Ramos*, L-3433, Jul. 16, 1951).

Art. 1434. When a person who is not the owner of a thing sells or alienates and delivers it, and later the seller or grantor acquires title thereto, such title passes by operation of law to the buyer or grantee.

COMMENT:

(1) Sale or Alienation by Non-Owner

(a) *Example:*

Jose sold in his own name Brigitte's car to Gina. He also delivered the car to Gina. If later on Brigitte donates the car to Jose, ownership over the same passes to Gina, not by tradition or delivery, but by *operation of law*.

- (b) In this kind of estoppel, prejudice is not essential. (*Vda. de Cruz v. Ilagan*, 46 O.G. No. 1, Supp. 352).
- (c) Art. 1434 applies to the sale of "after-acquired property." This is allowed by the law on Sales under the Civil Code.

(2) Cases**Inquimboy v. Paez Vda. de Cruz
L-13953, Jul. 26, 1960**

FACTS: Inquimboy sold a parcel of land to Albea in 1941, who in turn, without having fully paid the price, sold the same land to Cruz in 1943. The land was registered land, and when Albea sold it to Cruz, the land was still registered in Inquimboy's name. It was only in Feb. 1944 that the sale in favor of Albea was recorded. In May 1944, Albea's title was cancelled and the transfer certificate of title was issued to Cruz. Did Cruz really acquire title over the property?

HELD: Yes, because although Albea was not yet the registered owner at the time he sold it to Cruz, the fact remains that he (Albea) subsequently acquired valid title in his own name. This title was later transferred to Cruz. (*See Art. 1434, Civil Code*).

**Llacer v. Muñoz de Bustillo and Achaval
12 Phil. 328**

FACTS: At the time Llacer sold a piece of land to Munoz, Llacer was *not* yet the owner thereof. Later, Llacer acquired really the title over the land. *Issue:* Is the sale to Muñoz valid?

HELD: Yes. Llacer's subsequent acquisition of the land has the effect of making his conveyance of the same to Muñoz valid. (*See Pang Lim & Galvez v. Lo Seng, 42 Phil. 282*).

[*NOTE:* If, however, the deed of sale is alleged to be a *forgery*, this is a question of fact that should be threshed out in the trial court. (*Felix Molina v. Court of Appeals & Manjon, L-14524, Oct. 24, 1960*).]

Art. 1435. If a person in representation of another sells or alienates a thing, the former cannot subsequently set up his own title as against the buyer or grantee.

COMMENT:**(1) Sale or Alienation in Representation of Another**

This is estoppel created in a representative capacity. In this kind of estoppel, prejudice is also not essential. (*Felix Molina v. Court of Appeals & Manjon, L-14524, Oct. 24, 1960*).

(2) Example

Amalia, in representation of Romeo, sells to Juanito a car. Amalia cannot afterwards allege that she was really the owner of the car, and that, therefore, the sale is *not valid*.

Art. 1436. A lessee or a bailee is estopped from asserting title to the thing leased or received, as against the lessor or bailor.

COMMENT:**(1) Estoppel on the Part of a Lessee or a Bailee**

- (a) Under the Revised Rules of Court, one of the instances of conclusive presumptions is in the case of the *tenant*, who is not permitted to deny the title of his landlord at the time of the *commencement* of the relation of landlord and tenant between them. (*Sec. 3-b, Rule 131 and Lizada v. Omanan, 59 Phil. 547*).
- (b) Ordinarily, therefore, it is enough for the landlord to prove the *existence* of the *lease contract*, for the presumption to apply. (*Pascual v. Angeles, 4 Phil. 604*).
- (c) Note that the law refers to a *lessee* or *bailee* (such as a depository). (*See Delgado v. Bonnevie, et al., 23 Phil. 308*).
- (d) The presumption has also been applied to a *donee* who had accepted the donation in due form (*Franco, et al. v. Tutaan, [C.A.] 50 O.G. 4317*), as well as to a servant or agent. (*Barlin v. Ramirez, et al., 7 Phil. 41*).

(2) When Presumption Does Not Apply

If the alleged tenant does not admit expressly or implicitly the existence of the lease contract (such as when the landlord

did *not* attach or plead in his complaint the contract of lease), the presumption does not apply. (*Andres v. Judge Soriano, et al.*, L-10311, Jun. 29, 1957).

Art. 1437. When in a contract between third persons concerning immovable property, one of them is misled by a person with respect to the ownership or real right over the real estate, the latter is precluded from asserting his legal title or interest therein, provided all these requisites are present:

(1) **There must be fraudulent representation or wrongful concealment of facts known to the party estopped;**

(2) **The party precluded must intend that the other should act upon the facts as misrepresented;**

(3) **The party misled must have been unaware of the true facts; and**

(4) **The party defrauded must have acted in accordance with the misrepresentation.**

COMMENT:

(1) Estoppel Concerning Immovable Property

To apply this Article, one should have been *misled*, otherwise there is no estoppel. (*Fabie, et al. v. City of Manila, 10 Phil. 64* and *Cristobal v. Gomez, 50 Phil. 810*). Knowledge of the true facts by the stranger prevents deception, so estoppel cannot apply. (*Vinluan v. Herrera, 92 Phil. 1077*). On the part of the party who is to be in estoppel, should have made a fraudulent representation or wrongful concealment of facts known to him. (*Moller v. Sarile, L-7038, Aug. 31, 1955*).

(2) Cases

Fabie, et al. v. City of Manila 10 Phil. 64

FACTS: Prior to his application for title, Fabie made a plan where he mentioned a certain “*estero*” as the *boundary* of his property, implying that it was not included in the estate.

Later, he submitted a formal application, this time including the “*estero*” inside the estate. It was proved that the City of Manila, to whom the application was submitted, never saw the plan hereinabove referred to. *Issue*: Is Fabie in estoppel?

HELD: No, for the City could not have been misled, since its officials never saw the plan.

Cristobal v. Gomez
50 Phil. 810

FACTS: To misled others, two brothers, Epifanio and Marcelino Gomez, drew up a plan whereby Epifanio, although the registered owner of a parcel of land, admitted that Marcelino was really the owner. *Issue*: May Marcelino Gomez or his successors-in-interest claim ownership over the land by virtue of such written admission by Epifanio?

HELD: No, because Marcelino was a party to the collusion, and therefore, he could not have been misled. Had third parties been misled, there would have been estoppel.

(3) Effect of Consent on the Part of the True Owner

Acquiescence by the true owner estops him from asserting any right over the property. (*Cementina, et al. v. Court of Appeals, et al.*, 91 Phil. 922).

Cementina, et al. v. Court of Appeals, et al.
91 Phil. 922

FACTS: Ireneo and Isabel Cervantes owned conjugal land, which was sold after Isabel’s death to Pablo Concepcion by Ireneo, *with his children’s consent*. Later the children claimed part of the property stating that the sale, insofar as it referred to the portion inherited by them from their mother, Isabel, should be considered void because Ireneo could *not* validly sell the same.

HELD: The children are estopped from asserting their rights in view of their acquiescence to the sale.

Art. 1438. One who has allowed another to assume apparent ownership of personal property for the purpose of making any transfer of it, cannot, if he received the sum for which a

pledge has been constituted, set up his own title to defeat the pledge of the property, made by the other to a pledgee who received the same in good faith and for value.

COMMENT:

(1) Allowing Someone to Assume Apparent Ownership of Personal Property

- (a) This is estoppel that results from acceptance of benefits (with knowledge of the true facts).
- (b) *Example:*

A has a diamond ring. He allowed *B* to assume apparent ownership over the ring so that *B* might sell the same. Instead, *B* pledged the ring with *C* to obtain a loan. The money lent was later handed over to *A*. Later *A* attacks the validity of the pledge claiming that under the law, the pledgee must be the owner thereof, and since *B* in this case acted without authority, the pledge is invalid. Is *A* allowed to do this?

ANS.: No, *A* is not allowed to do this. His receipt of the sum for which the pledge was made is an implied ratification of the pledge and *A* is, therefore, in estoppel.

(2) When Estoppel Applies Even if There Be No Benefits

Even if there be NO benefits, estoppel would also apply if the “agent” was given apparent authority, and the other party was misled into giving him credit. (*Siy Cong Bieng v. Hongkong & Shanghai Bank*, 56 *Phil.* 598).

Art. 1439. Estoppel is effective only as between the parties thereto or their successors in interest.

COMMENT:

(1) Persons Bound by Estoppel

Both parties are, however, bound (*Andres v. Pimentel*, 21 *Phil.* 431) such as parties to a sale. (*Borlaza v. Borgonio*, GR 3433, July 16, 1951). Successors-in-interest (as well as privies

and grantees) are bound. (*19 Am. Jur. 809*). But third parties are not.

(2) Estoppel on the Part of a Minor

A minor possessed of discretion and cleverness may be bound by his own contract, even if entered into without parental authority. (*Sia Suan v. Alcantara, 47 O.G. 4561*).

(3) Is the Government Bound by Estoppel?

Generally, the Government is *not* bound by estoppel, particularly so if there has been an erroneous application and enforcement of the law. (*Phil. Long Distance Tel. Co. v. Coll. of Int. Rev., 90 Phil. 674*).

Examples:

- (a) In *People v. Go, et al., L-11368-69, Oct. 30, 1959*, the Supreme Court held that the fact that the clerk of the Supreme Court served notice upon the appellant that its brief must be printed and filed with the Court within 45 days from receipt of notice does not and cannot confer appellate jurisdiction upon said Court, where the appeal was taken BEYOND the period prescribed by the Rules of Court.
- (b) Any error made by a tax official in the assessment or computation of taxes does NOT have the effect of relieving the taxpayer from the full amount of liability as fixed by law. Errors of tax officers do not bind the government or prejudice its right to the taxes or dues collectible by it from the citizen. (*Lewin v. Galang, L-15253, Oct. 31, 1960 and Collector of Int. Rev. v. Ellen Wood McGrath, L-12710, L-12721, Feb. 28, 1961*). Estoppel cannot operate against a court and it can therefore dismiss a case anytime it discovers it has no jurisdiction. (*Perez v. Perez, L-14874, Sept. 30, 1960*).

[NOTE: In *Nilo, et al. v. Romero, L-15195, Mar. 29, 1961*, it was however held that where the defendant City was wrongly represented and its city attorney failed to file a motion to dismiss based on such ground, estoppel *operates* against said defendant City. The erroneous designation of the representative when the defendant City itself is named,

is NOT sufficient to set aside the proceeding had in the case.]

Antonio Favis, et al. v. Municipality of Sabongan
L-26522, Feb. 27, 1969

ISSUE: Does estoppel apply against a Municipal Corporation?

HELD: No. The doctrine of estoppel cannot be applied as against a Municipal Corporation to validate a contract which it has no authority to make — otherwise, it would be enabled to do indirectly what it cannot do directly. (*See Bartolome E. San Diego v. Municipality of Naujan, L-9920, Feb. 29, 1969*).

Republic v. Caballero
79 SCRA 177

If a government official illegally conveys public land to a person, the government is not estopped from recovering the same.

(4) Applicability to Questions of Fact

The rule on estoppel applies only to questions of fact, not of law, about the truth of which the other party is ignorant. (*Tanada & Macapagal v. Cuenco, et al., 100 Phil. 1101*).

Abines v. BPI
482 SCRA 421 (2006)

Note here that the public policy considerations behind forum shopping are superior to that of a party's claim of estoppel.

(5) Estoppel by Record

The doctrine of estoppel by record only applies as between the same parties or their privies and cannot be used against strangers. If in two cases the plaintiffs be different but the defendants are the same, the new plaintiffs are neither bound by the first proceedings, nor may they take advantage of the same. (*Beltran, et al. v. Escudero, et al., 99 Phil. 643*).

[NOTE: If party-litigant submit a case for decision without objection they cannot claim, for the first time on appeal, that they were deprived of the opportunity to submit additional evidence. They are guilty of estoppel. (Baradi & Bonita v. Ignacio, et al., L-8324, Jan. 19, 1956, O.G. 5172).]

(6) Estoppel Cannot Validate a Void Contract

Prudential Bank v. Panis GR 50008, Aug. 31, 1987

The doctrine of estoppel may not be invoked to validate a void contract. As between parties to a contract, validity cannot be given to it by estoppel if it is prohibited by law or is against public policy. No citizen is competent to barter away what public policy by law seeks to preserve.

(7) Promissory Estoppel

Mendoza v. Court of Appeals GR 116710, Jun. 25, 2001

FACTS: Petitioner obtained loans from a bank secured by mortgages on several and personal properties. Since he was having difficulty in meeting payments, he asked for restructuring of the loans. He was told by the bank to submit certain documents to determine if his request would be justified. He said that the bank approved his proposal for restructuring. For this purpose, he and his wife signed two blank promissory note forms in the belief that said notes were to be filled out by the bank to conform to a 5-year restructuring program agreed upon verbally. Instead of the 5-year period, petitioner claimed that the bank contravened their verbal agreement by affixing dates on the two notes to make them mature in 2, instead of 5 years and inserting interest rates of 21% instead of 18% as agreed upon. In a suit, petitioner filed for specific performance, nullification of extrajudicial foreclosure of his mortgaged property, and damages. He claimed that the bank had accepted his proposals for restructuring.

The Regional Trial Court (RTC) ordered the bank to restructure to 5 years the loan of petitioner and to pay certain specified damages. The Court of Appeals (CA) reversed the trial court and ruled that there is no evidence of a promise that the bank had accepted the proposals of petitioner for the restructuring of his loans. It ruled further petitioner's communications were mere proposals and the bank's responses were not categorical that petitioner's request had been favorably accepted by the bank.

ISSUE: Is petitioner correct in his argument that upon submission of the required documents for restructuring his proposed 5-year restructuring plan was deemed automatically approved by the bank?

HELD: The RTC's ruling is based on the *doctrine of promissory estoppel* enunciated in *Ramos v. Central Bank* (41 SCRA 565). This doctrine may arise from the making of a promise, even though without consideration, if it was intended that the promise should be relied upon, and if a refusal to enforce it would be virtually to sanction the perpetration of fraud or would result in other injustice. Reliance by promisee is generally evidenced by action or forbearance on his part, and the idea has been expressed that such action or forbearance would reasonably have been expected by the promisor.

With the doctrine serving as an exception to the general rule that a promise of future conduct does not constitute estoppel, certain elements, however, have to be established so as to be entitled to its benefit: (a) a promise reasonably expected to induce action or forbearance; (b) such promise did, in fact, induce action or forbearance; and (c) the party suffered a detriment as a result. Clearly, then, the doctrine presupposes the existence of a promise on the part of one against whom estoppel is claimed. The promise must be plain and unambiguous and sufficiently specific so that the judiciary can understand the obligations assumed and enforce the promise according to its terms.

In the case at bar, the petitioner failed to prove that the bank had promised to approve the plan in exchange for the submission of the proposal. Because no such promise was proven, the doctrine does not apply.

(8) Concept of an “Agency by Estoppel”**Litonjua, Jr. v. Eternit Corp.
490 SCRA 204 (2006)**

For an “agency by estoppel” to exist, the following must be established:

1. the principal manifested a representation of the agent’s authority or knowingly allowed the agent to assume such authority; or
2. the third person, in good faith, relied upon such representation; or
3. relying upon said representation, a third person has changed his position to his detriment.

An *agency by estoppel*, which is similar to the “doctrine of apparent authority,” requires proof of reliance upon the representations, and that, in turn, needs proof that the representations predated the action taken in reliance.

TITLE V. — TRUSTS

Chapter 1

GENERAL PROVISIONS

INTRODUCTORY COMMENT:

(1) ‘Trust’ Defined

- (a) It is the right to the beneficial enjoyment of property, the legal title to which is vested in another. (*65 C.J. 212*).
- (b) It is a fiduciary relationship concerning property which obliges the person holding it to deal with the property for the benefit of another. (*Pacheco v. Arro, 85 Phil. 505*). The person holding, in view of his equitable title, is allowed to exercise certain powers belonging to the owner of the legal title. (*54 Am. Jur. 21*).

Gelano v. Court of Appeals L-39050, Feb. 24, 1981

The word “trustee” as used in the corporation statute must be understood in the general concept, and may include the attorney prosecuting the case filed by the Corporation.

(2) Characteristics of a ‘Trust’

- (a) It is a fiduciary relationship. (*Pacheco v. Arro, 85 Phil. 505*).
- (b) Created by law or by agreement. (*Art. 1441, Civil Code*).
- (c) Where the legal title is held by one, and the equitable title or beneficial title is held by another. (*65 C.J. 212*).

(3) ‘Trust’ Distinguished from ‘Guardianship’ or ‘Executorship’

In a trust, the trustee or holder has LEGAL TITLE to the property; a guardian, administrator, or executor does not have.

(4) ‘Trust’ Distinguished from a ‘Stipulation Pour Autrui’

- (a) A trust may exist because of a legal provision or because of an agreement; a stipulation *pour autrui* can arise only in the case of contracts.
- (b) A trust refers to specific property; a stipulation *pour autrui* refers to specific property or to other things.

(5) Co-Ownership as a ‘Trust’

**Sotto v. Teves
L-38010, Oct. 31, 1978**

A co-ownership is a form of trust, with each co-owner being a trustee for each of the others.

Art. 1440. A person who establishes a trust is called the trustor; one in whom confidence is reposed as regards property for the benefit of another person is known as the trustee; and the person for whose benefit the trust has been created is referred to as the beneficiary.

COMMENT:

(1) Parties to a ‘Trust’

- (a) *trustor or settler* — he establishes the trust
- (b) *trustee* — holds the property in trust for the benefit of another
- (c) *beneficiary or cestui que trust* — the person for whose benefit the trust has been created

(NOTE: The trustor may at the same time be also the beneficiary.)

(2) Elements of a ‘Trust’

- (a) Parties to the trust
- (b) The *trust property* or the *trust estate* or the *subject matter of the trust*

Art. 1441. Trusts are either express or implied. Express trusts are created by the intention of the trustor or of the parties. Implied trusts come into being by operation of law.

COMMENT:**Classification of Trusts**

- (a) *Express trust* — created by the parties, or by the intention of the trustor. (*Art. 1441*).
- (b) *Implied trust* — created by operation of law (“trust by operation of law”).

[NOTE: There are two kinds of *implied* trusts:

- 1) *Resulting trust* — (also called bare or passive trust) — Here, there is an intent to create a trust but it is not effective as an express trust. [*Example: Art. 1451*, where a person who inherits property registers the same in another’s name, whom he does *not* intend to have any beneficial interest therein for he wants this for himself. (*See Severino v. Severino*, 44 Phil. 343; *See 65 C.J. 363*).]
- 2) *Constructive trust* — Here, no intention to create a trust is present, but a trust is nevertheless created by law to prevent unjust enrichment or oppression. [*Example: If a person acquires property by mistake*, he is considered by the law as a trustee while he holds the same. (*Art. 1456, Civil Code*). (*See Ocampo v. Zaporteza*, 53 Phil. 442).]

Art. 1442. The principles of the general law of trusts, insofar as they are not in conflict with this Code, the Code of Commerce, the Rules of Court and special laws are hereby adopted.

COMMENT:**(1) Suppletory Effect of the General Law of Trusts**

The principles of the general law of trusts are merely suppletory. (*Art. 1442*).

(2) Comment of the Code Commission

This Article incorporates a large part of the American law on trusts, and thereby the Philippine legal system will be amplified and will be rendered more suited to a just and equitable solution of many questions. (*Report of the Code Com., p. 60*).

(3) Anglo-American Precedents

As the law of trust has been much more frequently applied in the U.S. and in England than it has in Spain, such may be drawn freely upon Anglo-American precedents. This is particularly so, because Anglo-American trusts are derived from Roman and Civil Law nations. (*Gov't. v. Abadilla, 46 Phil. 642*).

(4) Cases

**Gelano v. Court of Appeals
L-39050, Feb. 24, 1981**

A lawyer who has been defending the interest of a corporation may, in the case of a litigation in court still pending after the expiration of the three-year period after dissolution, still continue as TRUSTEE of the corporation at least with respect to the matter in litigation. This would be in substantial compliance with the Corporation Code which allows the conveyance of the properties of a corporation to a trustee to enable it to prosecute and defend suits by or against the corporation beyond the three-year period.

**Rizal Surety & Insurance Co. v. CA
73 SCAD 606
(1996)**

The so-called adversary positions of the parties had no effect on the trust as it never changed the position of the parties in relation to each other and to the dollar proceeds.

The Loss and Subrogation Receipt did not exculpate petitioner from its liability for the accrued interest as this obligation arose in connection with its role as trustee. The signing of said receipt was a valid pre-condition before petitioner could be compelled to turn over the whole amount of the insurance to the two insured. It is grossly unfair for anyone to earn income on the money of another and still refuse to share any part of that income with the latter.

Chapter 2

EXPRESS TRUSTS

Art. 1443. No express trusts concerning an immovable or any interest therein may be proved by parol evidence.

COMMENT:

(1) Formalities Re Express Trusts

The law says that “no *express* trusts concerning an *immovable or any interest therein* may be *proved* by parol (oral) evidence.”

Therefore:

- (a) the requirement that the *express* trust be written is only for *enforceability*, not for validity between the parties. Hence, this Article may by analogy be included under the Statute of Frauds. (*See Gamboa v. Gamboa*, 52 Phil. 503).
- (b) By implication, for a trust over *personal property* an oral agreement is valid and enforceable between the parties.
- (c) Regarding *third persons*, the trust must be: in a public instrument and REGISTERED in the Registry of Property, if it concerns REAL PROPERTY.

(2) Distinguished from the Formalities of an Implied Trust

An *implied* trust (whether real or personal property is involved) may be proved by *oral* evidence. (*Art. 1457, Civil Code*).

Art. 1444. No particular words are required for the creation of an express trust, it being sufficient that a trust is clearly intended.

COMMENT:**(1) How an Express Trust Is Created**

- (a) By conveyance to the trustee by an act *inter vivos* or *mortis causa* (as in a will).
- (b) By admission of the *trustee* that he holds the property, only as *trustee*.

[In the case of *Geronimo & Isidro v. Nava & Aquino*, L-12111, Jan. 31, 1959, the Supreme Court held that where, pursuant to a court decision, the plaintiff not only allowed but even directed the tenant to pay the rentals to the defendants, and permitted the latter to occupy and take possession of the property when the tenant disoccupied it, such acts should be construed as a recognition of the fact that the property, though still in the former's name, was to be held *in trust* for the defendant, to be conveyed to him on payment of the purchase price, and such trust is an EXPRESS one.]

Julio v. Dalandan
L-19012, Oct. 20, 1967

FACTS: The deceased father of the defendants executed on Sept. 8, 1950 an *affidavit* attesting to the following facts:

- (a) that he owed someone a sum of money;
- (b) that as security thereof, he gave a parcel of land to the creditor;
- (c) that in view of his failure to pay the debt, the mortgage was foreclosed;
- (d) that he felt bound by such foreclosure;
- (e) that he therefore promises to replace said land by another lot or farm of approximately the same area on the condition that his children should *not* be forced to give the harvest, and on the further condition that substitution should *not* be required immediately.

This promise was accepted by the creditor.

The present case was instituted by the creditor to declare him owner of the land, and to fix the period for the delivery of the land to him. A motion to dismiss was filed on the ground of prescription, more than 10 years having elapsed.

ISSUE: Has the action by the creditor prescribed?

HELD: No, the action has *not* prescribed.

- (a) In the first place, the case involves an *express trust*. Under Art. 1444 of the Civil Code, no particular words are needed for the creation of an express trust. In this case the naked ownership of the land passed to the creditor, while the usufruct remained with the children of the deceased affiant for an *undetermined* period of time. The children are deemed to have held the land as trustees of the creditor. In view of the creation of the express trust, it is clear that no period of prescription is involved, the recovery being imprescriptible.
- (b) In the second place, assuming that there is no trust involved in this case, the period of prescription is, under the facts, a term of 30 years.

Observations on the Julio v. Dalandan case:

- (a) It is doubtful whether a trust was intended in this case. While it is true that no particular words are needed for the creation of an express trust, still there must be an *INTENT* to create a *fiduciary relationship* with respect to the property. No such relationship was contemplated in this case.
- (b) Indeed, if it is true that the naked ownership was immediately transferred to the creditor, and the children were the usufructuaries, it is the creditor who would be the trustee and the children would be the usufructuary — beneficiaries or the *cestui que trust* — *not* the other way around.
- (c) It is impossible to regard the creditor as the naked owner, for the affidavit (which was conformed to by the creditor) clearly stipulated that the substitution (of the land for the debt) would *not* be required immediately.
- (d) The alleged “substitution” was really in the form of a *da-tion* in payment or assignment to take place in the future.

Therefore, to determine whether the creditor's right had already prescribed, what the court should have done was to first fix a period for the transfer of the property. Later, the court could determine if more than 10 years (not 30 years) had elapsed from the date the transfer should have been done. (*See Art. 1144 of the Civil Code*).

(2) Clear Intent

There must be a CLEAR INTENTION to create a trust. (Thus, no particular or technical words are required.) (*Lorenzo v. Posadas*, 64 Phil. 353).

(3) Capacity

- (a) The *trustor* must be capacitated to *convey* property. [Hence, it has been held that a *minor* cannot create an express or conventional trust of any kind. (*Gayondato v. Treasurer*, 49 Phil. 244). However, a *joint owner* of a thing may be a trustor and the other a trustee of one's share. (*Lavadi v. De Mendoza*, 72 Phil. 186).]
- (b) The *trustee* must be capacitated to hold property and to enter into contracts.
- (c) The *beneficiary* must be capacitated to receive gratuitously from the trustor. (Therefore, if he is incapacitated to be the trustor's donee, heir or legatee, or devisee, he cannot become a beneficiary of a *gratuitous* trust.)

(4) Administration of the Trust

- (a) The trustee must file a bond. (*Sec. 5, Rule 98, Rules of Court*).
- (b) The trustee must make an inventory of the real and personal property in trust. (*Sec. 6[a], Rule 98, Rules of Court*).
- (c) The trustee must manage and dispose of the estate and faithfully discharge his trust in relation thereto, according to law or according to the terms of the trust instrument as long as they are legal and possible. (*Sec. 6[b], Rules 98, Rules of Court*).

- (d) The trustee must render a true and clear account. (*Sec. 6[c], Rule 98, Rules of Court*).
- (e) The trustee cannot acquire the property held in trust by prescription as long as the trust is admitted. (If he *repudiates*, and this is made known to the party involved, prescription is permitted). (*See Bancairen v. Diones, 98 Phil. 122*).

[NOTE: In *Escobar v. Locsin, 74 Phil. 86*, the Court had occasion to rule that a trust is sacred and inviolable, and the courts should therefore shield fiduciary relations against every manner of chicanery.]

QUERY: May a trustee of a trust estate be personally liable? HELD: In the absence of an express stipulation in a contract entered into by a trustee for a corporation that the trust estate and not the trustee should be liable on the contract, the trustee is liable in its individual capacity. (*Tan Senguan & Co. v. Phil. Trust Co., 58 Phil. 700*).

QUERY: When may a trustee sue as such? HELD: Before a trustee may sue or be sued alone as such, it is essential that his trust be EXPRESS, that is, a trust created by the direct and positive acts of the parties, by some writing, deed, or will or by proceedings in court. (*Philippine Air Lines, Inc. v. Heald Lumber Co., L-11479, Aug. 1957*).

Art. 1445. No trust shall fail because the trustee appointed declines the designation, unless the contrary should appear in the instrument constituting the trust.

COMMENT:

Effect if Trustee Declines

The trust ordinarily continues even if the trustee declines. Reason — the court will appoint a *new trustee*, unless otherwise provided for in the trust instrument. (*Sec. 3, Rule 98, Rules of Court*). A new trustee has to be appointed, otherwise the trust will not exist. (*65 C.J. 233*).

[NOTE: As between the mother and the uncle of a *minor*, the former ought to be preferred as *trustee* of the proceeds of an

insurance policy of the deceased father in the absence of evidence that would reveal the incompetence of the mother. (*Cabanas v. Pilapil*, L-25843, July 25, 1974).]

Art. 1446. Acceptance by the beneficiary is necessary. Nevertheless, if the trust imposes no onerous condition upon the beneficiary, his acceptance shall be presumed, if there is no proof to the contrary.

COMMENT:

(1) Necessity of Acceptance by the Beneficiary

For the trust to be effective, the beneficiary *must accept*:

- (a) *expressly*,
- (b) *or impliedly*,
- (c) *or presumably*.

(2) When Acceptance Is Presumed

If the granting of benefit is PURELY GRATUITOUS (no onerous condition), the acceptance by the beneficiary is presumed.

Exception: If there is proof that he really did NOT accept.

[NOTE: Acceptance by the beneficiary of a gratuitous trust is NOT subject to the *rules* for the *formalities* of donations. Therefore, even if real property is involved, acceptance by the beneficiary need not be in a public instrument. (*Cristobal v. Gomez*, 50 Phil. 810). Here, the court held that *mere acquiescence* in the formation of the trust, and *acceptance under the second paragraph of Art. 1311* (regarding a *stipulation pour autrui*) are *sufficient*.]

(3) How Express Trusts Are ENDED

- (a) Mutual agreement by *all the parties*
- (b) Expiration of the term

- (c) Fulfillment of the resolutory condition
- (d) Rescission or annulment (as in other contracts)
- (e) Loss of subject matter of the trust (physical loss or legal impossibility)
- (f) Order of the court (as when the purpose of the trust is being frustrated)
- (g) Merger
- (h) Accomplishment of the purpose of the trust

[NOTE: A testamentary trust for the administration and eventual sale of certain properties of the testator ends not at the time the trustee's petition for the sale of the property is approved by the court, but at the time said sale is actually made and the proceeds thereof distributed to the proper recipients. (Trusteeship of Estate of Benigno Diaz, L-1011, Aug. 31, 1960).]

Chapter 3

IMPLIED TRUSTS

INTRODUCTORY COMMENT:

Comment of the Code Commission

The *doctrine of implied trust* is founded on equity. The principle is applied in the American legal system to numerous cases where an injustice would result if the legal estate or title were to prevail over the equitable right of the beneficiary. (*Com. Report*, p. 60). Even though there has been no *fraud or immorality involved*, still there is a mutual antagonism between the trustee and the beneficiary. (*65 C.J. 222*). Fair dealing demands the establishment of the relation. (*Dixon v. Dixon*, 124 A. 198).

Art. 1447. The enumeration of the following cases of implied trust does not exclude others established by the general law of trust, but the limitation laid down in article 1442 shall be applicable.

COMMENT:

Enumeration of Instances of Implied Trust

The enumeration is *not* exclusive. But trusts are recognized only if *not* in conflict with:

- (a) the Civil Code,
- (b) the Code of Commerce,
- (c) the Rules of Court,
- (d) Special Laws.

Rabuco v. Hon. Antonio Villegas
L-24661, Feb. 28, 1974

The City of Manila only holds in trust, for the National Government, lands reserved for communal or community property. Therefore, if the national government decides to sell the parcels of land to their occupants, it cannot be said that the City of Manila is being deprived of property without due process of law.

Victorias v. Leuenberger and CA
GR 31189, Mar. 31, 1989

FACTS: In 1934, SG, the administratrix of the property left by her husband and of the conjugal partnership property, sold Lot A and Lot B, a 4-hectare portion of Lot 140, to the Municipality of Victorias. Said municipality used this lot as cemetery. Unfortunately, Victorias failed to register the deed of sale. When SG died in 1942, NL, the granddaughter claimed to have inherited the land from the former. In 1963, she had the property relocated and registered in her name. But the municipality prevented her from cultivating a portion of the lot, Lots A and B, because the same had been sold to the municipality. So, NL sued the municipality to recover the portion occupied by the latter.

HELD: As registered owner, NL is entitled to the protection afforded to a holder of a Torrens Title. Under the Torrens system, every person receiving a certificate of title in pursuance of a decree of registration shall hold the same free of all encumbrances except those noted in said certificate. (*Sec. 39, Art. 496, now Sec. 43, PD 1529*). In the instant case, however, NL admitted that she inherited the land from her grandmother, who had already sold the land to the municipality in 1934. Hence, she merely stepped into the shoes of her grandmother and she cannot claim a better right than her predecessor-in-interest. When she applied for registration of the disputed land, she had no legal right to do so as she had no ownership of the land since land registration is not a mode of acquiring ownership but only of confirming ownership of the land.

The Torrens system was not established as a means for the acquisition of title to private land. It is intended merely to

confirm and register the title which one may already have on the land. Where the applicant possesses no title or ownership over the parcel of land, he cannot acquire one under the Torrens system of registration. While an inherently defective Torrens Title may not ordinarily be cancelled even after proof of its defect, the law nevertheless safeguards the rightful party's interest in the titled land from fraud and improper use of technicalities by allowing such party, in appropriate cases, to judicially seek reconveyance to him of whatever he has been deprived of as long as the land has not been transferred or conveyed to a purchaser in good faith.

The land in dispute is held by NL in trust for the Municipality of Victorias, which can neither be deprived of its possession nor be made to pay rentals on it. NL is, in equity, bound to reconvey the land to the *cestui que trust*, the Municipality of Victorias. The Torrens system was never calculated to foment betrayal in the performance of a trust.

Art. 1448. There is an implied trust when property is sold, and the legal estate is granted to one party but the price is paid by another for the purpose of having the beneficial interest of the property. The former is the trustee, while the latter is the beneficiary. However, if the person to whom the title is conveyed is a child, legitimate or illegitimate, of the one paying the price of the sale, no trust is implied by law, it being disputably presumed that there is a gift in favor of the child.

COMMENT:

(1) Purchase of Property Where Title Is Not Given to Payer but to Another

- (a) This is a resulting trust (because a trust is intended).
- (b) *Reason:* One who pays for something usually does so for his own benefit. (See *Uy Aloc v. Cho Jan Jing*, 19 Phil. 202).
- (c) *Example of the Article:* A buys a piece of land from B. A pays the price so that he (A) may have the beneficial interest in the land BUT the legal title is given to C. C is the trustee and A is the beneficiary.

Suppose in the preceding example *C* was the legitimate or illegitimate child of *A*, is an implied trust still presumed in this case?

ANS.: No. Here, no trust is implied by law, it being disputably presumed that there is a gift in favor of the child. (*1st sentence, Art. 1448*).

[NOTE: It would seem that inasmuch as a presumption (*re* the existence of a donation) has been made by law, the formalities of a donation (indicated in Arts. 748 and 749 of the Civil Code) are NOT REQUIRED, for if the formalities are to be still complied with, there would be no need for the presumption.]

(2) Rule if Document Expresses a Different Intent

There is no implied trust if the document expresses a different intention.

Example:

A paid the money for the purchase of land, but title was given to *B*. It was proved that *A* paid because *A* was *lending* the amount to *B*. (*Armstrong v. Black, 46 Ariz. 507*).

Art. 1449. There is also an implied trust when a donation is made to a person but it appears that although the legal estate is transmitted to the donee, he nevertheless is either to have no beneficial interest or only a part thereof.

COMMENT:

When Donee Does Not Get Full Ownership of Benefit

This is again a “resulting trust,” where the “donee” becomes the trustee of the real beneficiary.

Example:

A donated land to *B*. But it was agreed that *B* is supposed to have only one-third of the products of said land. There is a trust here, with *B* as the trustee.

Art. 1450. If the price of a sale of property is loaned or paid by one person for the benefit of another and the conveyance is made to the lender or payor to secure the payment of the debt, a trust arises by operation of law in favor of the person to whom the money is loaned or for whom it is paid. The latter may redeem the property and compel a conveyance thereof to him.

COMMENT:

(1) Conveyance of Property so That It May Serve as Security

- (a) This is a “constructive trust,” the reason of the law being to prevent unjust enrichment.
- (b) *Example:*

Jose wants to buy a piece of land from Pedro, but Jose has no money. So Jose asks Carlos to pay for the land. The land is then given in Carlos’ name. This is supposed to be Carlos’ security until the debt of Jose is paid. Here an implied trust has been created. Carlos is only a trustee, the beneficiary being Jose. When Jose has the money, he may redeem the property from Carlos and compel a conveyance thereof to him (Jose). The trust here is implied, hence it exists even if in the title taken by Carlos, there is no mention of the interest of Jose or of his right to redeem.

(NOTE: Do not confuse the above example with the case; Jose borrows money from Carlos, and Jose later buys land in his own name. Jose then executes a mortgage on the land in favor of Carlos. This is NOT an implied trust. It is clearly a case of MORTGAGE.)

**Carantes v. Court of Appeals
76 SCRA 514**

No fiduciary relationship exists between the so-called “trustor” and the so-called “trustee” in a constructive trust.

(2) Trust Receipt

In connection with Art. 1450, mention may be made of what was referred to in *Phil. Nat. Bank v. Vda. y Hijos de Angel*

Jose, 63 Phil. 814, as a “trust receipt.” The Court said: “A trust receipt, as a contract, partakes of the nature of a conditional sale the importer becoming the absolute owner of the imported merchandise as soon as he has paid its price; until the owner or the person who advanced payment has been paid in full, or if the merchandise has already been sold, the proceeds turned over to him, the ownership continues to be vested in such person.”

(3) ‘Trust Receipt’ Defined

A *trust receipt* is a security transaction intended to aid in financing importers and retail dealers who do not have sufficient funds or resources to finance the importation or purchase of merchandise, and who may not be able to acquire credit except thru utilization, as collateral, of the merchandise imported or purchased. (*South City Homes, Inc., Fortune Motors [Phils.], Palawan Lumber Manufacturing Corp. v. BA Finance Corp., GR 135462, Dec. 7, 2001*).

(4) Case

**South City Homes, Inc., Fortune Motors (Phils.),
Palawan Lumber Manufacturing Corp. v.
BA Finance Corp.
GR 135462, Dec. 7, 2001**

FACTS: Petitioners posit that as an entruster, respondent BA Finance Corp. must first demand the return of the unsold vehicles from Fortune Motors Corp. (FMC, pursuant to the terms of the trust receipts.

HELD: Having failed to do so, petitioners had no cause of action whatsoever against FMC and the action for collection of sum of money was, therefore, premature.

(5) Default or Failure of Entrustee to Comply with Terms of Trust Agreement: Cancellation of Trust Not Absolutely Necessary

In the event of default by the entrustee on his obligations under a trust receipt agreement, it is not absolutely necessary that the entruster cancel the trust and take possession of the

goods to be able to enforce his rights thereunder. (*South City Homes, Inc., Fortune Motor [Phils.], Palawan Lumber Manufacturing Corp. v. BA Finance Corp., GR 135462, Dec. 7, 2001*).

Significantly the law (PD 115) uses the word “may” in granting to the entruster the right to cancel the trust and take possession of the goods. Consequently, petitioner has the discretion to avail of such right or seek any alternative action, such as a third party claim or a separate civil actions which it deems best to protect its right, at any time upon default or failure of the trustee to comply with any of the terms and conditions of the trust agreement. (*Ibid.*).

Art. 1451. When land passes by succession to any person and he causes the legal title to be put in the name of another, a trust is established by implication of law for the benefit of the true owner.

COMMENT:

(1) When Title to Inherited Land Is Not in Owner’s Name

- (a) This is a “resulting trust,” for a trust is intended.
- (b) *Example:* A inherited a piece of land from his father, but A caused the legal title to be put in the name of X, a brother. Here a trust is impliedly established, with X as trustee and A as the beneficiary.

(2) Rule in Co-Ownership

If a co-owner or co-heir possesses certain property owned in common by him and others, he is under the same situation as a trustee *insofar as the shares of the other co-owners are concerned*. (*Bargayo v. Camumot, 40 Phil. 857*).

**Mariano v. Judge De Vera
GR 59974, Mar. 9, 1987**

FACTS: H and W owned, as conjugal property, during their lifetime, 29 parcels of unregistered land. W died intestate in 1903 and without debts. She left her husband H, and their

two legitimate children *M* and *G* as her only forced heirs. In 1952, *H* died also intestate and without debts, leaving as his only compulsory heirs the children of *G* who, together with her sister *M*, had predeceased their father and his (*H*'s) legitimate children with his second wife.

In 1981 or 29 years after *H*'s death, the children of *G* (grandchildren of *H*) sued the children of *H* (begotten of the second wife) for partition. Plaintiffs alleged that defendants had taken possession of the whole conjugal property and appropriated to themselves (to the exclusion of plaintiffs) the products of said property. On motion of defendants, the trial judge dismissed the complaint saying that the right of action to enforce an implied or constructive trust prescribes in ten years.

HELD: The order of the trial court dismissing the complaint on the ground of prescription under Section 40 of Act 190 is wrong. This case is governed by the rules on co-ownership, since the parties are co-owners of the disputed properties, having inherited the same from a common ancestor. The existence of co-ownership argues against the theory of implied trust. Since defendants had not clearly repudiated the co-ownership, nor had they communicated such repudiation, if any, to plaintiffs, the former cannot acquire the shares of the latter by prescription.

(3) Paraphernal Properties Registered Under the Husband's Name

If properties inherited by a wife are registered under the husband's name, she can claim them as her own upon his death even if she does not refer to the situation as a trust. *Reason:* Here clearly a trust was intended. In *Severino v. Severino*, 44 Phil. 343, it was clearly ruled that the registration of property in the name of one who holds in a trust character does not extinguish the trust or destroy the rights of the beneficiary.

(4) Title in the Name of the Surviving Husband

In *Flores v. Flores*, 48 Phil. 288, it was held that "as long as the surviving husband retains the property of the conjugal estate itself, or its place, if sold, he holds it in the character of administrator and is virtually a trustee (except with reference

to his share) for those interested in the conjugal partnership. Nor does the obtaining of a Torrens Title in any way change the situation.”

(5) Right of Co-heirs

In *Castro v. Castro*, 57 Phil. 675, the Supreme Court observed that: “One who acquires a Torrens Title in his own name to property which he is administering for himself and his brother and sisters as heirs from a common ancestor, and *in common* descent, may be compelled to surrender to each of his co-heirs his appropriate share; and a proceeding for *partition* is an appropriate remedy by which to enforce this right.”

Art. 1452. If two or more persons agree to purchase property and by common consent the legal title is taken in the name of one of them for the benefit of all, a trust is created by force of law in favor of the others in proportion to the interest of each.

COMMENT:

(1) When Property Is in the Name of Only One of the Co-Buyers

- (a) This is a resulting trust in view of the intent to create a trust.
- (b) *Example:*

Uy Aloc v. Cho Jan Jing 19 Phil. 202

FACTS: Some Chinese merchants bought a lot with a house on it so that the same could be used as their clubhouse. The property was registered under the name of only one of them. The registered owner leased the property, collected rents therefor, and when asked for an accounting, refused to so account on the ground that he was the owner thereof.

HELD: He is a mere trustee, and is therefore obliged to render proper accounting. The beneficiaries are all the members of the club.

(2) Presumption That Shares Are Equal

The shares or interest of co-owners are presumed to be equal. (*Art. 485, 2nd par., Civil Code*).

Art. 1453. When property is conveyed to a person in reliance upon his declared intention to hold it for, or transfer it to another or the grantor, there is an implied trust in favor of the person whose benefit is contemplated.

COMMENT:**(1) When a Person Declares His Intent to Hold Property for Someone Else**

- (a) This is a “resulting trust” in view of the owner’s intention to create a trust.
- (b) *Example:* Jose bought from Pedro a parcel of land and it was conveyed to him (Jose) on Jose’s statement or declaration that he would hold it in behalf of Carlos. Here, Jose is merely the trustee, while Carlos is the beneficiary.
- (c) Suppose in the preceding example Jose asserts that he is really the owner, would he be allowed to do this?

ANS.: No, for he would be in estoppel. (See Art. 1431, Civil Code).

- (d) If a person promises to temporarily hold property and administer the same 'til it be freed from all debts and encumbrances, he is a mere trustee and must later on return the property. (*Martinez v. Grano, 42 Phil. 35*).

(2) Case

**Heirs of Emilio Candelaria v. Lucia Romero, et al.
L-12149, Sept. 30, 1960**

FACTS: Two brothers, Emilio and Lucas Candelaria, each purchased a lot on installment. Due to his inability to pay, Lucas sold his interest therein to Emilio, who continued payment of Lucas’ lot in the *name of Lucas* until the entire price was paid,

with the understanding that the necessary documents would be made *later*. In 1918 a Transfer Certificate of Title for the lot was issued in the name of Lucas. Lucas and his heirs *acknowledged* the fact that they held the title merely in trust for Emilio. In 1956, Emilio's heirs sued for reconveyance of the title to them. Lucas' heirs refused, firstly, on the ground that the trust was an express one and therefore not enforceable because it was oral; and secondly, on the ground of prescription (38 years).

HELD: Emilio's heirs are entitled to the reconveyance. *Firstly*, this is *not* express trust but an *implied one* under Art. 1453 and, therefore, may be proved by parol evidence. *Secondly*, while implied trusts may indeed prescribe, in the instant case, there was a continuous acknowledgment on the part of Lucas and his heirs; hence, there was no prescription.

Art. 1454. If an absolute conveyance of property is made in order to secure the performance of an obligation of the grantor toward the grantee, a trust by virtue of law is established. If the fulfillment of the obligation is offered by the grantor when it becomes due, he may demand the reconveyance of the property to him.

COMMENT:

Absolute Conveyance Made for Security Purpose

- (a) This is a "constructive trust," the purpose of the law being to prevent unjust enrichment to the prejudice of the true owner.
- (b) *Example:* Marlene was indebted to Susan. For the sole purpose of guaranteeing her debt, Marlene sold her parcel of land to Susan. Here, a trust has been created. If Marlene pays her debt when it becomes due, Marlene may demand the resale of the property to her.

Art. 1455. When any trustee, guardian or other person holding a fiduciary relationship uses trust funds for the purchase of property and causes the conveyance to be made to him or to a third person, a trust is established by operation of law in favor of the person to whom the funds belong.

COMMENT:**(1) Use of Trust Funds**

This is a “constructive trust” because again, the purpose is to prevent unjust enrichment.

(2) Applicability of Article

The Article applies to:

- (a) any trustee
- (b) guardian
- (c) or other person holding a fiduciary relationship (*Art. 1455*) (like an agent; therefore the acquisitions of the agent inure to the benefit of his principal). (*Severino v. Severino, 44 Phil. 343*).

(3) Example

An agent using his principal’s money purchases land in his own name. He also registers it under his name. Here, he will be considered only a trustee, and the principal is the beneficiary. The principal can bring an action for conveyance of the property to himself, so long as the rights of innocent third persons are not adversely affected. (*Camacho v. Mun. of Baliwag, 28 Phil. 466*).

(4) Reasons for the Rule

- (a) fiduciary or trust relations
- (b) estoppel
- (c) to remove the temptation to place self-interest above all other things, and at the expense of one’s integrity and duty to another. (*Severino v. Severino, 44 Phil. 343*).

(5) Cases

**Sing Joco v. Sunyantung, et al.
43 Phil. 589**

FACTS: A was a confidential employee of B. B intended to purchase an *hacienda* and he told A about it and of his option to

buy the same. Thinking that the purchase seems good, A, in his wife's name, bought the *hacienda*, to the prejudice of B. *Issue*: Can B sue A for damages?

HELD: Yes, in view of the breach of trust.

Escobar v. Locsin
74 Phil. 86

FACTS: Locsin was helping an illiterate owner in his claim for a parcel of land involved in certain cadastral proceedings. Locsin's help was at the request of the illiterate owner. Instead of really helping her, Locsin claimed the land for himself. The claim of Locsin was successful and he was awarded the land. May he be ordered to convey the land to the real owner?

HELD: Yes, for after all, there was a clear breach of trust here.

Art. 1456. If property is acquired through mistake or fraud, the person obtaining it is, by force of law, considered a trustee of an implied trust for the benefit of the person from whom the property comes.

COMMENT:

(1) Property Acquired Thru Mistake or Fraud

- (a) This is another example of a constructive trust.
- (b) *Example*:

Bella was given a car by Mina although it should have been given to Erlinda. Bella is considered as merely the trustee of the car for the benefit of Erlinda.

Laureano v. Stevenson
45 Phil. 252

FACTS: By mistake, a piece of land, belonging to his neighbor Laureano, was registered under the Torrens system (cadastral survey) under Kilayco's name, although Kilayco never claimed the land. Kilayco's creditors wanted to sell this land belonging to Laureano. *Issue*: Can they do so?

HELD: No. Since Kilayco never claimed the land, the court had no jurisdiction to order its registration in Kilayco's name. Kilayco in effect was only holding the property in trust for Laureano.

(*NOTE here* that in case of a trust, the *true owner* is preferred over the registered owner.)

[*NOTE*: It has been held that a trustee may be compelled to execute a deed of reconveyance of property that has been obtained improperly (*Ocampo v. Zaporteza*, 53 Phil. 442) provided, of course, that the true owner is not barred because of prescription or because of laches.]

(2) Nature of the Mistake or Fraud

- (a) The mistake referred to in Art. 1456 is a mistake made by a third person, not that made by a party to the contract. For if made by a party, no trust is created. (*Laureano v. Stevenson*, 45 Phil. 252).
- (b) Similarly, the fraud referred to in Art. 1456 is extra-contractual fraud and the effects are those as mentioned in Comment No. 4. (*Gemora v. Yap Tico*, 52 Phil. 616).

(3) Against Whom the Right Must Be Exercised

The right of action in an implied or constructive trust should be exercised against the trustee, who may have caused the fraud and *not* against an innocent purchaser for value. The action based on the trust should be filed *within four years* from the discovery of the fraud. Of course, if the alleged fraudulent deed was recorded in the Registry of Property, it is essential to count the four-year period from the date of the registration inasmuch as said registration operates as a notice to the whole world. (*Avecilla v. Yatco*, L-11578, May 14, 1958 and *Raymundo, et al. v. Afafe, et al.*, L-7651, Feb. 28, 1955).

(4) When the Article Does Not Apply

Ongsiako, et al. v. Ongsiako, et al. L-7510, Mar. 10, 1957

Art. 1456 does not apply to a donation of property which the donee has acquired thru a legal donation, even if she breaks an

important condition thereof. Thus, even with the breach condition, she does not become a trustee. It is still hers, subject to an action for revocation. If the action to revoke has prescribed, the property *cannot* be taken away from her. If prescription runs even in a case of an implied trust, prescription certainly runs with greater reason in a case like this, where as we have seen, no trust ever existed or was created.

Tiburcio Samonte v. CA, et al.
GR 104223, Jul. 12, 2001

FACTS: Petitioner, as successor-in-interest of the Jadol spouses, argues that the respondents' action for recoveyance, filed only in 1975, had long prescribed considering that the Jadol spouses caused the registration of a portion of the subject lot in their names way back in August 8, 1957. It is petitioner's contention that since 18 years had already lapsed from the issuance of TCT RT-476 until the time when respondents filed the action in the court *a quo* in 1975, the same was time-barred. As it had been indubitably established that fraud attended the registration of a portion of the subject property, the Jadol spouses were trustees thereof, on behalf of the surviving heirs of Abao. An action based on implied or constructive trust prescribes in 10 yrs. from the time of its creation or upon the alleged fraudulent registration of the property.

HELD: Petitioner's defense of prescription is untenable. The general rule that the discovery of fraud is deemed to have taken place upon the registration of real property because it is "considered a constructive notice to all persons" (*Sec. 51 of Act 496, as amended by Sec. 52 of PD 1529*) does not apply in this case. Instead the Court of Appeals (CA) correctly applied the ruling in *Adille v. CA* (57 SCRA 455 [1988]), which is quite apropos to the instant case, thus: "It is true that registration under the Torrens system is constructive notice of title, but it has likewise been our holding that the Torrens title does not furnish a shield for fraud. It is, therefore, no argument to say that the act of registration is equivalent to notice of repudiation, assuming there was one, notwithstanding the long standing rule that registration operates as a universal notice of title." In *Adille*, petitioner therein executed a deed of extrajudicial parti-

tion misrepresenting himself to be the sole heir of his mother when, in fact, she had other children. As a consequence, petitioner therein was able to secure title to the land in his name alone. His siblings then filed a case for partition on the ground that said petitioner was only a trustee on an implied trust of the property. Among the issues resolved by the Court in that case was prescription. Said petitioner registered the property in 1955 and the claim of private respondents therein was presented in 1974. Thus, in citing *Adille*, the Supreme Court said that in the instant case, the CA rightfully ruled that respondents action for reconveyance had not yet prescribed.

(5) Query – Do Trusts Prescribe?

- (a) Express trusts do NOT prescribe as long as they have not been repudiated. (*Diaz v. Garricho*, L-11229, Mar. 20, 1958).
- (b) The rule on implied trusts is, however, CONFUSING.

In *Diaz, et al. v. Garricho and Agriado*, L-11229, Mar. 20, 1958, the Court gave the reason why, as a rule, *express* trusts are *not* subject to prescription, while constructive trusts may be barred by lapse of time. And the reason is that in the express trust, there is a promise or a fiduciary relation, hence the possession of the trustee is NOT ADVERSE until and unless the beneficiary is made aware that the trust has been repudiated. But in the constructive trust, imposed as it is by law, there is no promise or fiduciary relation; the so-called trustee does *not* recognize any trust and has no intent to hold for the beneficiary; therefore, the beneficiary is *not justified* in delaying the action to recover his property. It is his fault if he delays; hence, he may be estopped by his own laches. (See *Avecilla v. Yatco*, L-11578, May 14, 1958).

However, in *Cordova, et al. v. Cordova, et al.*, L-9936, Jan. 14, 1958, the Court in an *obiter* made the statement that in a constructive trust (as in the case of co-heirship where one heir or co-owner fraudulently deprives the rest of their shares), prescription does not run. This doctrine of *imprescriptibility* of a *constructive* trust was reiterated in *Juan v. Zuñiga*, L-17044, April 28, 1962 and in *Jacinto v. Jacinto*, L-17955, L-17957, May 31, 1962, but is directly AT VARIANCE with the rule stated in

J.M. Tuason and Co. v. Macapagal, L-15539, Jan. 30, 1962, and in the case of *Cornelio Alzona, et al. v. Gregoria Capunitan, et al.*, L-10228, Feb. 28, 1962, where the Supreme Court held that indeed prescription RUNS in a constructive trust.

A decision of the Supreme Court *reiterates* this rule that a constructive trust is affected by prescription. Thus, in *Gerona, et al. v. Carmen de Guzman, et al.*, L-19060, May 29, 1964, the Supreme Court stated that although there are some decisions to the contrary, it is already settled that an action for reconveyance of real property based upon a constructive or implied trust, resulting from fraud, may be BARRED by prescription. The period is 4 years from the discovery of the fraud. The Court apparently overlooked the fact that exactly one month prior to said decision, it had ruled in *Caladiao v. Vda. de Blas*, L-19063, Apr. 29, 1964, that an action to compel reconveyance of property with a Torrens Title does *not* prescribe if the registered owner had obtained registration in *bad faith*, and the property is still in the latter's name. The reason is that the registration is in the nature of a continuing and subsisting trust.

Similarly, it has been held that prescription cannot be set up as a defense in an action that seeks to recover property held expressly in trust for the benefit of another; neither can laches, it being similar to prescription. (*Bachrach Motor Co. v. Lejano*, L-10910, Jan. 16, 1959).

(6) Some Cases

Ramos, et al. v. Gregoria Ramos, et al. L-19372, Dec. 3, 1974

ISSUE: Do trusts prescribe?

HELD:

- (1) *Express trusts do not prescribe.* This means that the beneficiary or *cestui que trust* can recover the property anytime. Reason for the rule — the possession of an express trustee is *not adverse*. [NOTE: Exception to the rule — even an express trust may prescribe if there has been repudiation of the same — see *Escay v. Court of Appeals*, L-37504, Dec. 18, 1974.]

- (2) With respect to *implied trusts*, a distinction must be made:
- (a) *resulting trusts* (those presumed to have been contemplated by the parties, but not so expressed in the instrument of conveyance) (examples: those referred to in Arts. 1448 to 1455, Civil Code) generally also *do not prescribe* (after all there was the *intent* to create an express trust). Exception — recovery from the trustee may prescribe if the trustee has expressly repudiated the trust;
 - (b) *constructive trusts* (justified merely by equity to satisfy the demands of justice, and therefore are not really trusts in the technical sense) *do prescribe*, and this rule is well-settled. (*NOTE*: Whether resulting or constructive, its enforcement may be barred by LACHES.) (See *Nacalaban v. Court of Appeals*, 80 SCRA 428 and *Duque v. Domingo*, 80 SCRA 654).

Armamento v. Central Bank
L-34228, Feb. 21, 1980

An action for reconveyance of registered land based on an implied trust prescribes in 10 years. This is so even if the decree of registration is no longer open to review.

Escay v. Court of Appeals
L-37504, Dec. 18, 1974

FACTS: Emilio Escay mortgaged his estate to the Philippine National Bank. However, in 1924, he died, with his debt still existing. His brother, Jose Escay, agreed to assume the debt so that there would be no foreclosure, so the ownership of the property was transferred to Jose in consideration of his assumption of the mortgage indebtedness but there was a *proviso* granting the heirs of Emilio the right to redeem the property within 5 years after Jose shall have fully paid the PNB. This agreement was approved by the probate court in 1934, the approval of all parties having been obtained, including the approval by the heirs of Emilio thru Emilio's wife. Many years later, Emilio's children brought the action to recover the estate from Jose, stating that:

(a) their previous consent has not been obtained *re* the transfer

of the property to Jose, (b) the probate court has no power to authorize the transfer as, in effect, this would be the same as a foreclosure, and (c) Jose refused to allow the heirs to redeem.

HELD:

- (a) The heirs may be said to have consented, thru their mother (their guardian *ad litem*).
- (b) The probate court had the power to approve the agreement, even if the same amounted to a foreclosure, for after all procedural rules cannot impair substantive rights of property owners to sell what belongs to them.
- (c) More than 25 years have elapsed since Jose took adverse possession of the property. It is clear that the action has prescribed. Under an express trust, if repudiated, may end after 10 years (or 30 years), as the case may be.

**Heirs of Tanak Pangaaran Patiwayon,
et al. v. Hon. Martinez, et al.
GR 49027, Jun. 10, 1985**

Where it appears that the land in question was obtained by defendants through fraudulent means of which a patent and title were issued in their name, they are deemed to hold it in trust for the person prejudiced by it. There being an implied trust, the action to recover the property prescribes in 10 years.

**Horacio G. Adaza & Felicidad Marundan v.
CA & Violeta G. Adaza, Assisted
by Her Husband Lino Amor
L-47354, Mar. 21, 1989**

In determining whether delay in seeking to enforce a right constitutes laches, the existence of a confidential relationship based upon, for instance, consanguinity, is an important circumstance for consideration. Delay in a situation where such a circumstance exists should not be as strictly construed, as where the parties are complete strangers *vis-a-vis* each other. The doctrine of laches is not to be applied mechanically as between near relatives; the fact that the parties in the instant case are brother and

sister tends to explain and excuse what would otherwise appear as long delay.

Moreover, continued recognition of the existence of the trust precludes the defense of laches. The two (2) letters sent by respondent Violeta to petitioner Horacio, one in 1969 and the other in 1971, show that Violeta as late as 1971 had recognized the trust imposed on her by law. Conversely, Horacio's reliance upon his blood relationship with his sister and the trust and confidence normally connoted in our culture by that relationship, should not be taken against him. Petitioner's counterclaim in the trial court for partition and reconveyance cannot be regarded as barred whether by laches or by prescription.

Gonzales, et al. v. IAC
GR 66479, Nov. 21, 1991

FACTS: Respondents have invoked Article 1456 of the Civil Code which states that "if property is acquired thru mistake or fraud, the person obtaining it is, by force of law, considered a trustee of an implied trust for the benefit of the person from whom the property comes."

HELD: The trust alluded to in this case is a constructive trust arising by operation of law. It is not a trust in the technical sense. Even assuming that there was an implied trust, respondent's attempt at reconveyance (functionally, an action for partition is both an action for declaration of ownership, and for segregation of conveyance of a determinate portion of the subject property) was barred by prescription. An action for reconveyance of real property to enforce an implied trust prescribes in ten years, the period reckoned from the issuance of the adverse title to the property which operates as a constructive notice. In the case at bar, that assertion of adverse title, which was an explicit indication of repudiation of the trust for the purpose of the statute of limitations, took place when OCT 496812 was issued in the name of Fausto Soy in 1932, to the exclusion of his three sisters. But even if there was no repudiation — as respondent Rosita Lopez would have us believe when she testified in court that while Fausto Soy

might have succeeded in securing title in his sole name, he nonetheless recognized the co-ownership between him and his sisters — the rule in this jurisdiction is that an action to enforce an implied trust may be circumscribed not only by prescription but also by laches, in which case repudiation is not even required. From 1932 to 1965, or a period of 33 years, respondents had slept on their rights, presuming they had any. They can no longer dispute the conclusive and incontrovertible character of Fausto Soy's title as they are deemed, by their unreasonably long inaction to have acquiesced therein. Moreover, the law protects those who are vigilant of their rights. Undue delay in the enforcement of a right is strongly indicative of a lack of merit in the claim, since it is human nature for persons to assert their rights most vigorously when threatened or invaded.

**Spouses Horacio & Felisa Benito v.
Agapita Saquitán-Ruiz
GR 149906, Dec. 26, 2002**

FACTS: The allegations in the complaint constituted a suit for reconveyance and not an action to invalidate certificates of title grounded on fraud.

Issue: What is the prescriptive period?

HELD: The prescriptive period is 10 years, not one year from entry of the decree of registration. Otherwise stated, the Court of Appeals is correct in holding that respondent's complaint is in reality an action for reconveyance based on implied or constructive trust. This suit prescribes 10 yrs. from issuance of title over the property. (*Villanueva-Mijares v. CA*, 330 SCRA 349 [2000] and *Marquez v. CA*, 300 SCRA 653 [1998]).

(7) How To Prove Trusts

**Salao, et al. v. Salao
L-26699, Mar. 16, 1976**

FACTS: Ambrosia Salao and Juan Salao (sister and brother) purchased from the heirs of Engracio Santiago the Calunuran fishpond, and were granted a Torrens Title over said property

in 1917. After Ambrosia's death, the heirs of Valentin Salao, the nephew of the two co-owners, sued in 1952 for reconveyance of the fishpond which they claimed had been held in trust for their father by the two registered co-owners. But no documentary evidence was presented to prove the existence of an express trust. All that they presented was oral testimony to the effect that in the partition of his (Valentin's) grandfather's estate, said fishpond had been assigned to him. *Issues*: (1) Was there an express trust? (2) Was there an implied trust? (3) Assuming there was an implied trust, has the action for reconveyance prescribed?

HELD:

- (1) There was no express trust. Oral or parol evidence cannot prove an express trust. (*Art. 1443, Civil Code*).
- (2) There was no implied trust, whether resulting trust or *constructive* trust. There was no resulting trust for there was never any intention to create a trust and there was no constructive trust, because the registration of the fishpond under the Torrens system was not initiated by fraud or mistake.
- (3) Assuming that there was an implied trust, the action is already barred by prescription or laches. (*See Varsity Hills, Inc. v. Navarro, 43 SCRA 503 and Alzona v. Capunitan & Reyes, 114 Phil. 377*). The action was filed only in 1952 or forty-one (41) years after the registration. The plaintiffs, and their predecessor in interest (Valentin Salao), slept on their rights, if they had any rights at all. *Vigilanti prospiciunt jura* ("The law protects him who is watchful of his rights"). Further, there was laches or unreasonable delay in trying to enforce a right. If there be laches, this is not only persuasive of a want of merit, but may, according to the circumstances, be destructive of the right itself. (*Buenaventura v. David, 37 Phil. 435*).

[NOTE: However, although prescription and laches may defeat an implied trust, there is one exception to the rule. Movables acquired thru a crime cannot be acquired by the offender thru prescription. (*Art. 1133, Civil Code*).]

[NOTE: While Art. 1456 is *not* retroactive in character, still it merely expresses a rule already recognized by our Courts

even prior to the promulgation of the New Civil Code. (*Diaz v. Garricho & Agriado, supra.*.)]

(8) How ‘Creative Trusts’ Are Created

This is by way of equity to prevent unjust enrichment, arising against one who, by fraud, duress or abuse of confidence, obtains or holds the legal right to property which he ought not, in equity and good conscience, to hold. (*Catalina Vda. de Retuerto v. Angelo P. Barz & Merlinda Barz, GR 148180, Dec. 19, 2001*).

Art. 1457. An implied trust may be proved by oral evidence.

COMMENT:

(1) Proof of Implied Trust

- (a) This Article applies whether the property is *real* or *personal*.
- (b) The rule in Art. 1457 is *different* from that enunciated in Art. 1443 which states that “*no express* trust concerning an immovable or any *interest therein* may be proved by *parol evidence*.”

(2) Oral Evidence for Trust Must Be Trustworthy

Salao v. Salao
L-26699, Mar. 16, 1976

While an implied trust may be proved by *oral evidence*, still, said evidence must be a *trustworthy oral evidence*, for oral evidence may be easily fabricated.

Appendix

REPUBLIC ACT NO. 8792

AN ACT PROVIDING FOR THE RECOGNITION AND USE OF ELECTRONIC COMMERCIAL AND NON-COMMERCIAL TRANSACTIONS AND DOCUMENTS, PENALTIES FOR UNLAWFUL USE THEREOF AND FOR OTHER PURPOSES

Be it enacted by the Senate and House of Representatives of the Republic of the Philippines in Congress assembled:

PART I

SHORT TITLE AND DECLARATION OF POLICY

Section 1. *Short Title.* — This Act shall be known as the “Electronic Commerce Act of 2000”.

Sec. 2. *Declaration of Policy.* — The State recognizes the vital role of information and communications technology (ICT) in nation-building; the need to create an information-friendly environment which supports and ensures the availability, diversity and affordability of ICT products and services; the primary responsibility of the private sector in contributing investments and services in telecommunications and information technology; the need to develop, with appropriate training programs and institutional policy changes, human resources for the information technology age, a labor force skilled in the use of ICT and a population capable of operating and utilizing electronic appliances and computers; its obligation to facilitate the transfer and promotion of adaptation technology, to ensure network security, connectivity and neutrality of technology for the national benefit; and the need to marshal, organize and deploy national information infrastructures, comprising in both telecommunications network and strategic information services, including their interconnection to the global information networks, with the necessary and appropriate

legal, financial, diplomatic and technical framework, systems and facilities.

PART II

ELECTRONIC COMMERCE IN GENERAL

Sec. 3. *Objective.* — This Act aims to facilitate domestic and international dealings, transactions, arrangements, agreements, contracts and exchanges and storage of information through the utilization of electronic, optical and similar medium, mode, instrumentality and technology to recognize the authenticity and reliability of electronic documents related to such activities and to promote the universal use of electronic transaction in the government and general public.

Sec. 4. *Sphere of Application.* — This Act shall apply to any kind of data message and electronic document used in the context of commercial and non-commercial activities to include domestic and international dealings, transactions, arrangements, agreements, contracts and exchanges and storage of information.

Sec. 5. *Definition of Terms.* — For the purposes of this Act, the following terms are defined, as follows:

a. “Addressee” refers to a person who is intended by the originator to receive the electronic data message or electronic document. The term does not include a person acting as an intermediary with respect to that electronic data message or electronic document.

b. “Computer” refers to any device or apparatus which, by electronic, electro-mechanical or magnetic impulse, or by other means, is capable of receiving, recording, transmitting, storing, processing, retrieving, or producing information, data, figures, symbols or other modes of written expression according to mathematical and logical rules or of performing any one or more of those functions.

c. “Electronic Data Message” refers to information generated, sent, received or stored by electronic, optical or similar means.

d. “Information and Communications System” refers to a system intended for and capable of generating, sending, receiving, storing or otherwise processing electronic data messages or electronic documents and includes the computer system or other similar device by or in which data is recorded or stored and any procedures related

to the recording or storage of electronic data message or electronic document.

e. “Electronic Signature” refers to any distinctive mark, characteristic and/or sound in electronic form, representing the identity of a person and attached to or logically associated with the electronic data message or electronic document or any methodology or procedures employed or adopted by a person and executed or adopted by such person with the intention of authenticating or approving an electronic data message or electronic document.

f. “Electronic Document” refers to information or the representation of information, data, figures, symbols or other modes of written expression, described or however represented, by which a right is established or an obligation extinguished, or by which a fact may be proved and affirmed, which is received, recorded, transmitted, stored, processed, retrieved or produced electronically.

g. “Electronic Key” refers to a secret code which secures and defends sensitive information that crosses over public channels into a form decipherable only with a matching electronic key.

h. “Intermediary” refers to a person who in behalf of another person and with respect to a particular electronic document sends, receives and/or stores or provides other services in respect of that electronic document.

i. “Originator” refers to a person by whom, or on whose behalf, the electronic document purports to have been created, generated and/or sent. The term does not include a person acting as an intermediary with respect to that electronic document.

j. “Service Provider” refers to a provider of -

(i) On-line services or network access, or the operator of facilities therefor, including entities offering the transmission, routing, or providing of connections for online communications, digital or otherwise, between or among points specified by a user, of electronic documents of the user’s choosing; or

(ii) The necessary technical means by which electronic documents of an originator may be stored and made accessible to a designated or undesignated third party;

Such service providers shall have no authority to modify or alter the content of the electronic data message or electronic document

received or to make any entry therein on behalf of the originator, addressee or any third party unless specifically authorized to do so, and who shall retain the electronic document in accordance with the specific request or as necessary for the purpose of performing the services it was engaged to perform.

CHAPTER II

LEGAL RECOGNITION OF ELECTRONIC WRITING OR DOCUMENT AND DATA MESSAGES

Sec. 6. *Legal Recognition of Data Messages.* — Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is in the data message purporting to give rise to such legal effect, or that it is merely referred to in that electronic data message.

Sec. 7. *Legal Recognition of Electronic Documents.* — Electronic documents shall have the legal effect, validity or enforceability as any other document or legal writing, and -

(a) Where the law requires a document to be in writing, that requirement is met by an electronic document if the said electronic document maintains its integrity and reliability and can be authenticated so as to be usable for subsequent reference, in that —

(i) The electronic document has remained complete and unaltered, apart from the addition of any endorsement and any authorized change, or any change which arises in the normal course of communication, storage and display; and

(ii) The electronic document is reliable in the light of the purpose for which it was generated and in the light of all the relevant circumstances.

(b) Paragraph (a) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for the document not being presented or retained in its original form.

(c) Where the law requires that a document be presented or retained in its original form, that requirement is met by an electronic document if —

(i) There exists a reliable assurance as to the integrity

of the document from the time when it was first generated in its final form; and

(ii) That document is capable of being displayed to the person to whom it is to be presented: *Provided*, That no provision of this Act shall apply to vary any and all requirements of existing laws on formalities required in the execution of documents for their validity.

For evidentiary purposes, an electronic document shall be the functional equivalent of a written document under existing laws.

This Act does not modify any statutory rule relating to the admissibility of electronic data messages or electronic documents, except the rules relating to authentication and best evidence.

Sec. 8. *Legal Recognition of Electronic Signatures*. — An electronic signature on the electronic document shall be equivalent to the signature of a person on a written document if that signature is proved by showing that a prescribed procedure, not alterable by the parties interested in the electronic document, existed under which —

(a) A method is used to identify the party sought to be bound and to indicate said party's access to the electronic document necessary for his consent or approval through the electronic signature;

(b) Said method is reliable and appropriate for the purpose for which the electronic document was generated or communicated, in the light of all the circumstances, including any relevant agreement;

(c) It is necessary for the party sought to be bound, in order to proceed further with the transaction, to have executed or provided the electronic signature; and

(d) The other party is authorized and enabled to verify the electronic signature and to make the decision to proceed with the transaction authenticated by the same.

Sec. 9. *Presumption Relating to Electronic Signatures*. — In any proceedings involving an electronic signature, it shall be presumed that —

(a) The electronic signature is the signature of the person to whom it correlates; and

(b) The electronic signature was affixed by that person with the intention of signing or approving the electronic document unless

the person relying on the electronically signed electronic document knows or has notice of defects in or unreliability of the signature or reliance on the electronic signature is not reasonable under the circumstances.

SEC. 10. *Original Documents.* — (1) Where the law requires information to be presented or retained in its original form, that requirement is met by an electronic data message or electronic document if:

(a) the integrity of the information from the time when it was first generated in its final form, as an electronic data message or electronic document is shown by evidence *aliunde* or otherwise; and

(b) where it is required that information be presented, that the information is capable of being displayed to the person to whom it is to be presented.

(2) Paragraph (1) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for the information not being presented or retained in its original form.

(3) For the purposes of subparagraph (a) of paragraph (1):

(a) the criteria for assessing integrity shall be whether the information has remained complete and unaltered, apart from the addition of any endorsement and any change which arises in the normal course of communication, storage and display; and

(b) the standard of reliability required shall be assessed in the light of the purpose for which the information was generated and in the light of all relevant circumstances.

SEC. 11. *Authentication of Electronic Data Messages and Electronic Documents.* — Until the Supreme Court by appropriate rules shall have so provided, electronic documents, electronic data messages and electronic signatures, shall be authenticated by demonstrating, substantiating and validating a claimed identity of a user, device, or another entity in an information or communication system, among other ways, as follows:

(a) The electronic signature shall be authenticated by proof that a letter, character, number or other symbol in electronic form

representing the persons named in and attached to or logically associated with an electronic data message, electronic document, or that the appropriate methodology or security procedures, when applicable, were employed or adopted by a person and executed or adopted by such person, with the intention of authenticating or approving an electronic data message or electronic document;

(b) The electronic data message and electronic document shall be authenticated by proof that an appropriate security procedure, when applicable was adopted and employed for the purpose of verifying the originator of an electronic data message and/or electronic document, or detecting error or alteration in the communication, content or storage of an electronic document or electronic data message from a specific point, which, using algorithm or codes, identifying words or numbers, encryptions, answers back or acknowledgment procedures, or similar security devices.

The Supreme Court may adopt such other authentication procedures, including the use of electronic notarization systems as necessary and advisable, as well as the certificate of authentication on printed or hard copies of the electronic document or electronic data messages by electronic notaries, service providers and other duly recognized or appointed certification authorities.

The person seeking to introduce an electronic data message and electronic document in any legal proceeding has the burden of proving its authenticity by evidence capable of supporting a finding that the electronic data message and electronic document is what the person claims it to be.

In the absence of evidence to the contrary, the integrity of the information and communication system in which an electronic data message or electronic document is recorded or stored may be established in any legal proceeding —

(a) By evidence that at all material times the information and communication system or other similar device was operating in a manner that did not affect the integrity of the electronic data message and/or electronic document, and there are no other reasonable grounds to doubt the integrity of the information and communication system;

(b) By showing that the electronic data message and/or electronic document was recorded or stored by a party to the proceedings who is adverse in interest to the party using it; or

(c) By showing that the electronic data message and/or electronic document was recorded or stored in the usual and ordinary course of business by a person who is not a party to the proceedings and who did not act under the control of the party using the record.

SEC. 12. *Admissibility and Evidential Weight of Electronic Data Message and Electronic Documents.* — In any legal proceedings, nothing in the application of the rules on evidence shall deny the admissibility of an electronic data message or electronic document in evidence —

- a. On the sole ground that it is in electronic form; or
- b. On the ground that it is not in the standard written form and electronic data message or electronic document meeting, and complying with the requirements under Sections 6 or 7 hereof shall be the best evidence of the agreement and transaction contained therein.

In assessing the evidential weight of an electronic data message or electronic document, the reliability of the manner in which it was generated, stored or communicated, the reliability of the manner in which its originator was identified, and other relevant factors shall be given due regard.

SEC. 13. *Retention of Electronic Data Message and Electronic Document.* — Notwithstanding any provision of law, rule or regulation to the contrary —

(a) The requirement in any provision of law that certain documents be retained in their original form is satisfied by retaining them in the form of an electronic data message or electronic document which —

- i. Remains accessible so as to be usable for subsequent reference;
- ii. Is retained in the format in which it was generated, sent or received, or in a format which can be demonstrated to accurately represent the electronic data message or electronic document generated, sent or received;
- iii. Enables the identification of its originator and addressee, as well as the determination of the date and the time it was sent or received.

(b) The requirement referred to in paragraph (a) is satisfied by using the services of a third party, provided that the conditions set forth in subparagraphs (i), (ii) and (iii) of paragraph (a) are met.

SEC. 14. *Proof By Affidavit.* — The matters referred to in Section 12, on admissibility and Section 9, on the presumption of integrity, may be presumed to have been established by an affidavit given to the best of the deponent's knowledge subject to the rights of parties in interest as defined in the following section.

SEC. 15. *Cross-Examination.* — (1) A deponent of an affidavit referred to in Section 14 that has been introduced in evidence may be cross-examined as of right by a party to the proceedings who is adverse in interest to the party who has introduced the affidavit or has caused the affidavit to be introduced.

(2) Any party to the proceedings has the right to cross-examine a person referred to in Section 11, paragraph 4, sub-paragraph c.

CHAPTER III

COMMUNICATION OF ELECTRONIC DATA MESSAGES AND ELECTRONIC DOCUMENTS

SEC. 16. *Formation and Validity of Electronic Contracts.* — (1) Except as otherwise agreed by the parties, an offer, the acceptance of an offer and such other elements required under existing laws for the formation of contracts may be expressed in, demonstrated and proved by means of electronic data message or electronic documents and no contract shall be denied validity or enforceability on the sole ground that it is in the form of an electronic data message or electronic document, or that any or all of the elements required under existing laws for the formation of the contracts is expressed, demonstrated and proved by means of electronic documents.

(2) Electronic transactions made through networking among banks, or linkages thereof with other entities or networks, and vice versa, shall be deemed consummated upon the actual dispensing of cash or the debit of one account and the corresponding credit to another, whether such transaction is initiated by the depositor or by an authorized collecting party: *Provided*, that the obligation of one bank, entity, or person similarly situated to another arising therefrom

shall be considered absolute and shall not be subjected to the process of preference of credits.

SEC. 17. *Recognition by Parties of Electronic Data Message or Electronic Document.* — As between the originator and the addressee of an electronic data message or electronic document, a declaration of will or other statement shall not be denied legal effect, validity or enforceability solely on the ground that it is in the form of a electronic data message.

SEC. 18. *Attribution of Electronic Data Message.* — (1) An electronic data message or electronic document is that of the originator if it was sent by the originator himself.

(2) As between the originator and the addressee, an electronic data message or electronic document is deemed to be that of the originator if it was sent:

(a) by a person who had the authority to act on behalf of the originator with respect to that electronic data message or electronic document; or

(b) by an information system programmed by, or on behalf of the originator to operate automatically.

(3) As between the originator and the addressee, an addressee is entitled to regard an electronic data message or electronic document as being that of the originator, and to act on that assumption, if:

(a) in order to ascertain whether the electronic data message or electronic document was that of the originator, the addressee properly applied a procedure previously agreed to by the originator for that purpose; or

(b) the electronic data message or electronic document as received by the addressee resulted from the actions of a person whose relationship with the originator or with any agent of the originator enabled that person to gain access to a method used by the originator to identify electronic data messages as his own.

(4) Paragraph (3) does not apply:

(a) as of the time when the addressee has both received notice from the originator that the electronic data message or electronic document is not that of the originator, and has reasonable time to act accordingly; or

(b) in a case within paragraph (3) sub-paragraph (b), at any time when the addressee knew or should have known, had it exercised reasonable care or used any agreed procedure, that the electronic data message or electronic document was not that of the originator.

(5) Where an electronic data message or electronic document is that of the originator or is deemed to be that of the originator, or the addressee is entitled to act on that assumption, then, as between the originator and the addressee, the addressee is entitled to regard the electronic data message or electronic document as received as being what the originator intended to send, and to act on that assumption. The addressee is not so entitled when it knew or should have known, had it exercised reasonable care or used any agreed procedure, that the transmission resulted in any error in the electronic data message or electronic document as received.

(6) The addressee is entitled to regard each electronic data message or electronic document received as a separate electronic data message or electronic document and to act on that assumption, except to the extent that it duplicates another electronic data message or electronic document and the addressee knew or should have known, had it exercised reasonable care or used any agreed procedure, that the electronic data message or electronic document was a duplicate.

SEC. 19. Error on Electronic Data Message or Electronic Document. — The addressee is entitled to regard the electronic data message or electronic document received as that which the originator intended to send, and to act on that assumption, unless the addressee knew or should have known, had the addressee exercised reasonable care or used the appropriate procedure -

(a) That the transmission resulted in any error therein or in the electronic document when the electronic data message or electronic document enters the designated information system, or

(b) That electronic data message or electronic document is sent to an information system which is not so designated by the addressee for the purposes.

SEC. 20. Agreement on Acknowledgment of Receipt of Electronic Data Messages or Electronic Documents. — The following rules shall apply where, on or before sending an electronic data message or elec-

tronic document, the originator and the addressee have agreed, or in that electronic document or electronic data message, the originator has requested, that receipt of the electronic document or electronic data message be acknowledged:

(a) Where the originator has not agreed with the addressee that the acknowledgment be given in a particular form or by a particular method, an acknowledgment may be given by or through any communication by the addressee, automated or otherwise, or any conduct of the addressee, sufficient to indicate to the originator that the electronic data message or electronic document has been received.

(b) Where the originator has stated that the effect or significance of the electronic data message or electronic document is conditional on receipt of the acknowledgment thereof, the electronic data message or electronic document is treated as though it has never been sent, until the acknowledgment is received.

(c) Where the originator has not stated that the effect or significance of the electronic data message or electronic document is conditional on receipt of the acknowledgment, and the acknowledgment has not been received by the originator within the time specified or agreed or, if no time has been specified or agreed, within a reasonable time, the originator may give notice to the addressee stating that no acknowledgment has been received and specifying a reasonable time by which the acknowledgment must be received; and if the acknowledgment is not received within the time specified in subparagraph (c), the originator may, upon notice to the addressee, treat the electronic document or electronic data message as though it had never been sent, or exercise any other rights it may have.

SEC. 21. Time of Dispatch of Electronic Data Messages or Electronic Documents. — Unless otherwise agreed between the originator and the addressee, the dispatch of an electronic data message or electronic document occurs when it enters an information system outside the control of the originator or of the person who sent the electronic data message or electronic document on behalf of the originator.

SEC. 22. Time of Receipt of Electronic Data Messages or Electronic Documents. — Unless otherwise agreed between the originator and the addressee, the time of receipt of an electronic data message or electronic document is as follows:

(a) If the addressee has designated an information system for the purpose of receiving electronic data message or electronic docu-

ment, receipt occurs at the time when the electronic data message or electronic document enters the designated information system: *Provided, however*, that if the originator and the addressee are both participants in the designated information system, receipt occurs at the time when the electronic data message or electronic document is retrieved by the addressee.

(b) If the electronic data message or electronic document is sent to an information system of the addressee that is not the designated information system, receipt occurs at the time when the electronic data message or electronic document is retrieved by the addressee;

(c) If the addressee has not designated an information system, receipt occurs when the electronic data message or electronic document enters an information system of the addressee.

These rules apply notwithstanding that the place where the information system is located may be different from the place where the electronic data message or electronic document is deemed to be received.

SEC. 23. *Place of Dispatch and Receipt of Electronic Data Messages or Electronic Documents.* — Unless otherwise agreed between the originator and the addressee, an electronic data message or electronic document is deemed to be dispatched at the place where the originator has its place of business and received at the place where the addressee has its place of business. This rule shall apply even if the originator or addressee had used a laptop or other portable device to transmit or receive his electronic data message or electronic document. This rule shall also apply to determine the tax situs of such transaction.

For the purpose hereof —

a. If the originator or the addressee has more than one place of business, the place of business is that which has the closest relationship to the underlying transaction or, where there is no underlying transaction, the principal place of business.

b. If the originator of the addressee does not have a place of business, reference is to be made to its habitual residence; or

c. The “usual place of residence” in relation to a body corporate, means the place where it is incorporated or otherwise legally constituted.

SEC. 24. *Choice of Security Methods.* — Subject to applicable laws and/or rules and guidelines promulgated by the Department of Trade and Industry with other appropriate government agencies, parties to any electronic transaction shall be free to determine the type and level of electronic data message and electronic document security needed, and to select and use or implement appropriate technological methods that suit their needs.

PART III

ELECTRONIC COMMERCE IN SPECIFIC AREAS

CHAPTER I.

CARRIAGE OF GOODS

SEC. 25. *Actions Related to Contracts of Carriage of Goods.* — Without derogating from the provisions of part two of this law, this chapter applies to any action in connection with, or in pursuance of, a contract of carriage of goods, including but not limited to:

- (a) (i) furnishing the marks, number, quantity or weight of goods;
- (ii) stating or declaring the nature or value of goods;
- (iii) issuing a receipt for goods;
- (iv) confirming that goods have been loaded;
- (b) (i) notifying a person of terms and conditions of the contract;
- (ii) giving instructions to a carrier;
- (c) (i) claiming delivery of goods;
- (ii) authorizing release of goods;
- (iii) giving notice of loss of, or damage to, goods;
- (d) giving any other notice or statement in connection with the performance of the contract;
- (e) undertaking to deliver goods to a named person or a person

(f) granting, acquiring, renouncing, surrendering, transferring or negotiating rights in goods;

(g) acquiring or transferring rights and obligations under the contract.

SEC. 26. *Transport Documents*. — (1) Where the law requires that any action referred to contract of carriage of goods be carried out in writing or by using a paper document, that requirement is met if the action is carried out by using one or more data messages or electronic documents.

(2) Paragraph (1) applies whether the requirement therein is in the form of an obligation or whether the law simply provides consequences for failing either to carry out the action in writing or to use a paper document.

(3) If a right is to be granted to, or an obligation is to be acquired by, one person and no other person, and if the law requires that, in order to effect this, the right or obligation must be conveyed to that person by the transfer, or use of, a paper document, that requirement is met if the right or obligation is conveyed by using one or more electronic data messages or electronic documents unique;

(4) For the purposes of paragraph (3), the standard of reliability required shall be assessed in the light of the purpose for which the right or obligation was conveyed and in the light of all the circumstances, including any relevant agreement.

(5) Where one or more data messages are used to effect any action in subparagraphs (f) and (g) of Section 25, no paper document used to effect any such action is valid unless the use of electronic data message or electronic document has been terminated and replaced by the use of paper documents. A paper document issued in these circumstances shall contain a statement of such termination. The replacement of electronic data messages or electronic documents by paper documents shall not affect the rights or obligations of the parties involved.

(6) If a rule of law is compulsorily applicable to a contract of carriage of goods which is in, or is evidenced by, a paper document, that rule shall not be inapplicable to such a contract of carriage of goods which is evidenced by one or more electronic data messages or electronic documents by reason of the fact that the contract is

evidenced by such electronic data messages or electronic documents instead of by a paper document.

PART IV

ELECTRONIC TRANSACTIONS IN GOVERNMENT

SEC. 27. *Government Use of Electronic Data Messages, Electronic Documents and Electronic Signatures.* — Notwithstanding any law to the contrary, within two (2) years from the date of the effectivity of this Act, all departments, bureaus, offices and agencies of the government, as well as all government-owned and-controlled corporations, that pursuant to law require or accept the filing of documents, require that documents be created, or retained and/or submitted, issue permits, licenses or certificates of registration or approval, or provide for the method and manner of payment or settlement of fees and other obligations to the government, shall —

(a) accept the creation, filing or retention of such documents in the form of electronic data messages or electronic documents;

(b) issue permits, licenses, or approval in the form of electronic data messages or electronic documents;

(c) require and/or accept payments, and issue receipts acknowledging such payments, through systems using electronic data messages or electronic documents; or

(d) transact the government business and/or perform governmental functions using electronic data messages or electronic documents, and for the purpose, are authorized to adopt and promulgate, after appropriate public hearing and with due publication in newspapers of general circulation, the appropriate rules, regulations, or guidelines, to, among others, specify —

(1) the manner and format in which such electronic data messages or electronic documents shall be filed, created, retained or issued;

(2) where and when such electronic data messages or electronic documents have to be signed, the use of a electronic signature, the type of electronic signature required;

(3) the format of an electronic data message or electronic

document and the manner the electronic signature shall be affixed to the electronic data message or electronic document;

(4) the control processes and procedures as appropriate to ensure adequate integrity, security and confidentiality of electronic data messages or electronic documents or records or payments;

(5) other attributes required of electronic data messages or electronic documents or payments; and

(6) the full or limited use of the documents and papers for compliance with the government requirements: *Provided*, That this Act shall by itself mandate any department of the government, organ of state or statutory corporation to accept or issue any document in the form of electronic data messages or electronic documents upon the adoption, promulgation and publication of the appropriate rules, regulations, or guidelines.

SEC. 28. *RPWEB To Promote the Use Of Electronic Documents and Electronic Data Messages In Government and to the General Public.* — Within two (2) years from the effectivity of this Act, there shall be installed an electronic online network in accordance with Administrative Order 332 and House of Representatives Resolution 890, otherwise known as RPWEB, to implement Part IV of this Act to facilitate the open, speedy and efficient electronic online transmission, conveyance and use of electronic data messages or electronic documents amongst all government departments, agencies, bureaus, offices down to the division level and to the regional and provincial offices as practicable as possible, government owned and controlled corporations, local government units, other public instrumentalities, universities, colleges and other schools, and universal access to the general public.

The RPWEB network shall serve as initial platform of the government information infrastructure (GII) to facilitate the electronic online transmission and conveyance of government services to evolve and improve by better technologies or kinds of electronic online wide area networks utilizing, but not limited to, fiber optic, satellite, wireless and other broadband telecommunication mediums or modes. To facilitate the rapid development of the GII, the Department of Transportation and Communications, National Telecommunications Commission and the National Computer Center are hereby

directed to aggressively promote and implement a policy environment and regulatory or non-regulatory framework that shall lead to the substantial reduction of costs of including, but not limited to, lease lines, land, satellite and dial-up telephone access, cheap broadband and wireless accessibility by government departments, agencies, bureaus, offices, government owned and controlled corporations, local government units, other public instrumentalities and the general public, to include the establishment of a government website portal and a domestic internet exchange system to facilitate strategic access to government and amongst agencies thereof and the general public and for the speedier flow of locally generated internet traffic within the Philippines.

The physical infrastructure of cable and wireless systems for cable TV and broadcast excluding programming and content and the management thereof shall be considered as within the activity of telecommunications for the purpose of electronic commerce and to maximize the convergence of ICT in the installation of the GII.

SEC. 29. Authority of the Department of Trade and Industry and Participating Entities. — The Department of Trade and Industry (DTI) shall direct and supervise the promotion and development of electronic commerce in the country with relevant government agencies, without prejudice to the provisions of Republic Act 7653 (Charter of Bangko Sentral ng Pilipinas) and Republic Act No. 337 (General Banking Act), as amended.

Among others, the DTI is empowered to promulgate rules and regulations, as well as provide quality standards or issue certifications, as the case may be, and perform such other functions as may be necessary for the implementation of this Act in the area of electronic commerce to include, but shall not be limited to, the installation of an online public information and quality and price monitoring system for goods and services aimed in protecting the interests of the consuming public availing of the advantages of this Act.

PART V

FINAL PROVISIONS

SEC. 30. Extent of Liability of a Service Provider. — Except as otherwise provided in this Section, no person or party shall be sub-

ject to any civil or criminal liability in respect of the electronic data message or electronic document for which the person or party acting as a service provider as defined in Section 5 merely provides access if such liability is founded on —

(a) The obligations and liabilities of the parties under the electronic data message or electronic document;

(b) The making, publication, dissemination or distribution of such material or any statement made in such material, including possible infringement of any right subsisting in or in relation to such material: *Provided, That:*

i. The service provider does not have actual knowledge, or is not aware of the facts or circumstances from which it is apparent, that the making, publication, dissemination or distribution of such material is unlawful or infringes any rights subsisting in or in relation to such material;

ii. The service provider does not knowingly receive a financial benefit directly attributable to the unlawful or infringing activity; and

iii. The service provider does not directly commit any infringement or other unlawful act and does not induce or cause another person or party to commit any infringement or other unlawful act and/or does not benefit financially from the infringing activity or unlawful act of another person or party: *Provided, further, That* nothing in this Section shall affect —

a) Any obligation founded on contract;

b) The obligation of a service provider as such under a licensing or other regulatory regime established under written law; or

c) Any obligation imposed under any written law;

d) The civil liability of any party to the extent that such liability forms the basis for injunctive relief issued by a court under any law requiring that the service provider take or refrain from actions necessary to remove, block or deny access to any material, or to preserve evidence of a violation of law.

SEC. 31. *Lawful Access.* — Access to an electronic file, or an electronic signature of an electronic data message or electronic document

shall only be authorized and enforced in favor of the individual or entity having a legal right to the possession or the use of the plaintext, electronic signature or file and solely for the authorized purposes. The electronic key for identity or integrity shall not be made available to any person or party without the consent of the individual or entity in lawful possession of that electronic key.

SEC. 32. *Obligation of Confidentiality.* — Except for the purposes authorized under this Act, any person who obtained access to any electronic key, electronic data message, or electronic document, book, register, correspondence, information, or other material pursuant to any powers conferred under this Act, shall not convey to or share the same with any other person.

SEC. 33. *Penalties.* — The following Acts shall be penalized by fine and/or imprisonment, as follows:

(a) Hacking or cracking which refers to unauthorized access into or interference in a computer system/server or information and communication system; or any access in order to corrupt, alter, steal, or destroy using a computer or other similar information and communication devices, without the knowledge and consent of the owner of the computer or information and communications system, including the introduction of computer viruses and the like, resulting in the corruption, destruction, alteration, theft or loss of electronic data messages or electronic document shall be punished by a minimum fine of one hundred thousand pesos (P100,000.00) and a maximum commensurate to the damage incurred and a mandatory imprisonment of six (6) months to three (3) years;

(b) Piracy or the unauthorized copying, reproduction, dissemination, distribution, importation, use, removal, alteration, substitution, modification, storage, uploading, downloading, communication, making available to the public, or broadcasting of protected material, electronic signature or copyrighted works including legally protected sound recordings or phonograms or information material on protected works, through the use of telecommunication networks, such as, but not limited to, the internet, in a manner that infringes intellectual property rights shall be punished by a minimum fine of one hundred thousand pesos (P100,000.00) and a maximum commensurate to the damage incurred and a mandatory imprisonment of six (6) months to three (3) years;

(c) Violations of the Consumer Act or Republic Act No. 7394 and other relevant or pertinent laws through transactions covered by or using electronic data messages or electronic documents, shall be penalized with the same penalties as provided in those laws;

(d) Other violations of the provisions of this Act, shall be penalized with a maximum penalty of one million pesos (P1,000,000.00) or six (6) years imprisonment.

SEC. 34. *Implementing Rules and Regulations.* — The DTI, Department of Budget and Management and the Bangko Sentral ng Pilipinas are hereby empowered to enforce the provisions of this Act and issue implementing rules and regulations necessary, in coordination with the Department of Transportation and Communications, National Telecommunications Commission, National Computer Center, National Information Technology Council, Commission on Audit, other concerned agencies and the private sector, to implement this Act within sixty (60) days after its approval.

Failure to issue rules and regulations shall not in any manner affect the executory nature of the provisions of this Act.

SEC. 35. *Oversight Committee.* — There shall be a Congressional Oversight Committee composed of the Committees on Trade and Industry/Commerce, Science and Technology, Finance and Appropriations of both the Senate and House of Representatives, which shall meet at least every quarter of the first two years and every semester for the third year after the approval of this Act to oversee its implementation. The DTI, DBM, Bangko Sentral ng Pilipinas, and other government agencies as may be determined by the Congressional Committee shall provide a quarterly performance report of their actions taken in the implementation of this Act for the first three (3) years.

SEC. 36. *Appropriations.* — The amount necessary to carry out the provisions of Secs. 27 and 28 of this Act shall be charged against any available funds and/or savings under the General Appropriations Act of 2000 in the first year of effectivity of this Act. Thereafter, the funds needed for the continued implementation shall be included in the annual General Appropriations Act.

SEC. 37. *Statutory Interpretation.* — Unless otherwise expressly provided for, the interpretation of this Act shall give due regard to its international origin and the need to promote uniformity in its

application and the observance of good faith in international trade relations. The generally accepted principles of international law and convention on electronic commerce shall likewise be considered.

SEC. 38. *Variation by Agreement.* — As between parties involved in generating, sending, receiving, storing or otherwise processing electronic data message or electronic document, any provision of this Act may be varied by agreement between and among them.

SEC. 39. *Reciprocity.* — All benefits, privileges, advantages or statutory rules established under this Act, including those involving practice of profession, shall be enjoyed only by parties whose country of origin grants the same benefits and privileges or advantages to Filipino citizens.

Sec. 40. *Separability Clause.* — The provisions of this Act are hereby declared separable and in the event of any such provision is declared unconstitutional, the other provisions, which are not affected, shall remain in force and effect.

Sec. 41. *Repealing Clause.* — All other laws, decrees, rules and regulations or parts thereof which are inconsistent with the provisions of this Act are hereby repealed, amended or modified accordingly.

Sec. 42. *Effectivity.* — This Act shall take effect immediately after its publication in the Official Gazette or in at least two (2) national newspapers of general circulation.

Approved:

(Sgd.) PRESIDENT JOSEPH E. ESTRADA

CIVIL CODE of the PHILIPPINES ANNOTATED

By

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(1986-1992)*

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To my dearly beloved wife Gloria,[†] my loving children Emmanuel, Edgardo, Jr., and Eugene; my caring daughter-in-law Ylva Marie, and my intelligent grandchildren Yla Gloria Marie and Edgardo III — in all of whom I have found inspiration and affection — I dedicate this humble work.

PUBLISHER'S PREFACE TO THE 2008 EDITION

There are numerous new cases decided by the Supreme Court in the matter of Obligations and Contracts. While many of these decisions merely reiterate existing jurisprudence, there are some, nonetheless, which illustrate comparatively new concepts. Obviously, with the dawning of the 21st century, there is much judicial progress in this highly-important field of law; principally the advent of electronic contracts *vis-a-vis* e-commerce, and the spawning of derivatives (new exotic financial instruments based on hedging) — a new phenomenon in contracts law.

For the eventual realization of this revised and expanded edition, the Publisher hereby values the solicitous help rendered by Dr. Edgardo “Edgie” C. Paras, Jr. (LL.B., LL.M., and D.C.L.), a product of the United States (Harvard), Europe (Hague Academy of International Law), and Asia (National University of Singapore, Ateneo de Manila, San Beda, and UST Graduate School of Law). Grateful acknowledgments are likewise made to Prof. Emmanuel C. Paras (senior partner of Sycip Salazar Hernandez & Gatmaitan law firm) and RTC Judge of Makati, Metro Manila, Eugene C. Paras, for additional research.

— REX BOOK STORE

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